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No. ——

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1993

VICTOR TEICHER, VICTOR TEICHER & CO., AND ROSS FRANKEL, PETITIONERS

v.

UNITED STATES OF AMERICA, RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a defendant may be convicted of securities fraud and mail fraud for trading *while in possession* of misappropriated, material nonpublic information, when his trades were not *based on* or *caused by* that information.

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OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-21a) is reported at 987 F.2d 112. The principal opinion of the district court (App., *infra*, 22a-62a) is reported at 785 F. Supp. 1137.

JURISDICTION

The judgment of the court of appeals was entered on March 2, 1993, and a timely petition for rehearing was denied on April 26, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Relevant portions of 15 U.S.C. 78j(b), 78n(e), and 78ff, 18 U.S.C. 1341, and 17 C.F.R. 240.10b-5 and 240.14e-3 are set out in an appendix to this petition.

STATEMENT

In this case, the court of appeals concluded that a person who trades securities while in possession of misappropriated material nonpublic information may be convicted of securities fraud even if he did not rely on that information in making his trades. That extraordinary conclusion upsets an understanding of the law that had been widely shared by securities law practitioners and market participants. It calls into question the legality of market practices that are well-established and widely used. And it works a dramatic expansion in the reach of Sections 10(b) and 14(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b) and 78n(e)), and Rules 10b-5 and 14e-3 thereunder (17 C.F.R. 240.10b-5 and 240.14e-3), tearing them loose from their foundations in the common law of fraud—the very approach that was condemned by this Court in *Chiarella* v. *United States*, 445 U.S. 222, 227-228 & n.9, 233 (1980). Further review therefore is in order.

1. Petitioner Victor Teicher & Co., which manages pools of funds contributed by individual investors, is in the business of risk arbitrage. App., *infra*, 3a.[1] Petitioner Victor Teicher ("Teicher") was primarily responsible for the investment decisions made on behalf of the various accounts controlled by the company. Petitioner Ross Frankel was an analyst in the arbitrage department of the investment banking firm Drexel Burnham Lambert, Inc. ("Drexel"). Like any market analyst or arbitrageur, Teicher and Frankel operated by searching out and analyzing information on publicly traded securities. Some of this information came from sources in the public domain, including newspapers, trade journals, and publicly filed corporate documents. J.A. 1536-1544. Some of it also came from analysts, traders, and other market par-

[1] As the court of appeals explained, "[a]rbitrage entails trading in securities in companies that are the subject of changes in corporate control in order to take advantage of fluctuations in the price of these securities," Pet. App. 3a.

ticipants; petitioners depended on these sources for rumors, not generally known to the trading public, concerning possible future acquisitions or changes in corporate control. *Id.* at 1534-1536.

As this Court has recognized, such activities by analysts and arbitrageurs—so long as they do not involve trading on the basis of material nonpublic information that was disclosed in breach of a duty to the shareholders of the company whose shares are traded—are both legitimate and "necessary to the preservation of a healthy market. It is commonplace for analysts to 'ferret out and analyze information,' * * *. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities." *Dirks* v. *SEC*, 463 U.S. 646, 658-659 (1983) (citation omitted). The Court thus has observed "that '[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors.' " *Id.* at 658 n.17 (citation omitted).

2. This case grew out of allegations that petitioners traded while in possession of material nonpublic information concerning the companies whose shares they bought or sold. Viewing the evidence in the light most favorable to the prosecution, Teicher and Frankel received tips of nonpublic information from two sources. The first was Michael David, an associate at the law firm of Paul, Weiss, Rifkind, Wharton, and Garrison ("Paul Weiss"), who was a social acquaintance of Teicher and a self-described aspiring arbitrageur. See App., *infra*, 4a; J.A. 758-759, 763-764, 857-860, 861-864. The second was Robert Salsbury, another acquaintance of Teicher, who was a subordinate of Frankel at Drexel. App., *infra*, 4a.

Again viewing the evidence in the light most favorable to the prosecution (although it was in fact sharply disputed at trial), the jury could have found that David gave Teicher tips about four transactions that he surmised, on the basis of confidential Paul Weiss information, might

occur: a possible acquisition of American Can, Inc., by Triangle Industries, Inc.; a possible acquisition of Allegheny International, Inc., by Ampco-Pittsburgh, Inc.; two possible tender offer bids for Avondale Mills by Dominion Textile Co., Ltd.; and a possible acquisition of American Brands, Inc., by BAT Industries, PLC. In addition, David gave Teicher a tip, originating from someone at the investment firm of Marcus Schloss & Co., Inc., about an anticipated leveraged buyout bid for Revco, D.S., Inc., at a particular price. See App., *infra*, 4a-9a. Teicher subsequently traded in the shares of American Can, Avondale Mills, Allegheny, American Brands, and Revco. As for Salsbury, the jury could have found that he disclosed to Teicher the so-called "phantom list" of companies for which Drexel was providing acquisition-related services. *Id.* at 4a. Teicher subsequently traded in the shares of three companies on the list. The jury also could have found that Salisbury, using information he had gotten from David, told Frankel about the possible acquisition of American Brands. *Id.* at 7a-8a.

The evidence also showed, however, that some of these tips were so speculative and indefinite—and, as it happens, inaccurate—that they would have been of distinctly limited value in trading. About the bid for Allegheny, for example, David stated merely that "a client of Paul Weiss, Ampco-Pittsburgh, was looking very closely at Allegheny International and that it may or may not mean anything but it was something to be followed." J.A. 798-799. Concerning Dominion's second tender offer bid for Avondale Mills, David told Teicher only that he had seen officials of the company (which was in the midst of a three-way tender offer battle) meeting with their Paul Weiss attorneys. App., *infra*, 6a. David's suggestion that Triangle intended to take over American Can was simply incorrect; undisputed evidence at trial established that Triangle asked Paul Weiss to determine whether Triangle's acquisition of a *different* company (National Can) would pose antitrust barriers to other potential future acquisitions, including the *negotiated* pur-

chase of American Can's packaging division. See J.A. 1284-1285, 1288-1292, 1293. David's tips about the potential acquisitions of Allegheny and American Brands were similarly insubstantial and misleading. Outside of initial inquiries with Paul Weiss, which resulted in immediate negative assessments, neither BAT nor Ampco-Pittsburgh made any decisions or undertook any preliminary planning to effect the acquisitions about which David speculated. See *id.* at 1253-1258, 1267-1273, 1274.

There also was reason to doubt that petitioners in fact relied on the tips. Evidence was placed before the jury from which it could have found that Teicher's and Frankel's trades were substantially motivated by publicly available information that they had gathered and analyzed. See, *e.g.*, J.A. 210-216, 325-328, 333-347, 348-352, 357-360, 845-846, 1366-1368, 1559, 1560-1562, 1563-1564, 1567, 1568-1570, 1571-1577, 1578-1579. At the same time, the evidence demonstrated that Teicher's trading activity often bore no correlation—and sometimes was flatly inconsistent—with the tips. For example, told by David that American Can might be the target of a takeover, Teicher purchased 5000 shares at an average price of $70.78, but at the same time sold options with a strike price of $70. *Id.* at 230-231, 331. This trading position effectively prevented Teicher from participating in any upward movement of the stock. *Id.* at 1404-1407. Similarly, Teicher sold all of his shares of American Can the day after purchasing them (*id.* at 230-231), even though no news regarding the company had come out in the meantime, and, indeed, David had told him only a short time earlier that a takeover attempt would take place "within six months" if "at all." *Id.* at 785. And told that the bid for Revco would be up to $35 a share (*id.* at 843), Teicher sold 5000 shares short at $33.62 to $33.75 (*id.* at 240), a position that could have exposed him to losses of over $1 per share had the information been correct.

3. Petitioners were indicted on charges relating to the David and Salsbury tips. All were charged under 18 U.S.C. 371 with conspiracy to commit securities fraud, in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder; fraud in connection with a tender offer, in violation of Section 14(e) of the Act and Rule 14e-3 thereunder; and mail fraud, in violation of 18 U.S.C. 1341 (Count 1). Teicher and Victor Teicher & Co. also were charged with nine substantive counts of securities fraud under Section 10(b) and Rule 10b-5 (Counts 2-10) and two counts of fraud in connection with a tender offer under Section 14(e) and Rule 14e-3 (Counts 11-12). Teicher was charged individually with seven counts of mail fraud under Section 1341, although all but two of the Counts (13 and 14) were dismissed by the district court. Frankel was charged with one count of securities fraud (Count 8) and one count of mail fraud (Count 15).[2] The theory of the indictment was that David and Salsbury "misappropriated" nonpublic information from their employers (Paul Weiss and Drexel, respectively),[3] and that petitioners committed fraud by trading while in possession of that information. See J.A. 122-124; App., *infra*, 15a; *United States* v. *Victor Teicher & Co.*, 726 F. Supp. 1424, 1430 (S.D.N.Y. 1989) (the "alleged violations spring from the misappropriation of inside information by a third party").

One of petitioners' principal defenses at trial was that they did not rely on the David and Salsbury tips in making their trades. The district court, however, specifically in-

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[2] Frankel also was charged with one count of perjury before the SEC (Count 16) and two counts of obstruction of justice (Counts 17 and 18). His convictions on those counts were upheld on appeal and are not challenged here.

[3] For Count 9, which addressed the trades involving Revco stock, the allegation was that the information was misappropriated from the persons who had entrusted it to Marcus Schloss & Co. See J.A. 123-124.

structed the jury that use of the misappropriated information was not an element of the securities fraud offense and charging the jurors that they accordingly did *not* have to find that the tips caused the trades. The court thus repeatedly informed the jury that petitioners were charged simply with trading "while in possession of material nonpublic information" (J.A. 1620, 1621, 1623, 1624, 1627). And over a defense objection (*id.* at 1594-1595) it expressly instructed the jury:

> The government need not prove a causal relationship between the misappropriated material nonpublic information and the defendants' trading. That is, the government need not prove that the defendants purchased or sold securities because of the material nonpublic information that they knowingly possessed. It is sufficient if the government proves that the defendants purchased or sold securities while knowingly in possession of the material nonpublic information.

App., *infra*, 16a; J.A. 1623-1624. Petitioners were convicted on all counts.[4]

4. The court of appeals affirmed the convictions, concluding that a defendant may be convicted of securities fraud for trading while in possession of material nonpublic information that was misappropriated from a third party, even if that information was not in fact the basis for his trades. App., *infra*, 1a-21a. The court recognized that "[a] causal connection standard would find no violation where a trader executes a previously and legitimately planned transaction after the trader wrongfully receives material nonpublic information which confirmed the transaction." *Id.* at 16a. But the court rejected that approach

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[4] Teicher was sentenced to concurrent terms of 18 months' imprisonment on Counts 1-13 and a suspended term on Count 14; fined $20,000 per count on Counts 1-10; and assessed $50 per count on all 14 counts. Victor Teicher & Co. was fined $60,000 per count on Counts 1-10 and assessed $200 per count on all counts. Frankel was sentenced to concurrent terms of 18 months' imprisonment on each count and fined $10,000.

in favor of the standard, advocated by the government, "that a violation of § 10(b) and Rule 10b-5 occurs when a trade is conducted [while] in 'knowing possession' of material nonpublic information." *Id.* at 17a.

The court reasoned that "[a] number of factors weigh in favor of a 'knowing possession' standard." First, the court opined that Section 10(b) and Rule 10b-5 "require only that a deceptive practice be conducted 'in connection with the purchase or sale of a security,' " a standard that the court believed must be construed flexibly. App., *infra,* 18a. Second, the court explained that "a 'knowing possession' standard comports with the oft-quoted maxim that one with a fiduciary or similar duty to hold material nonpublic information in confidence must either 'disclose or abstain' with regard to trading." *Ibid.* And third, the court found that "a 'knowing possession' standard has the attribute of simplicity," observing that "[u]nlike a loaded weapon which may stand ready but unused, material information cannot lay idle in the human brain." *Id.* at 19a. The court therefore concluded "[a]s a matter of policy" that "a requirement of a causal connection between the information and the trade could frustrate attempts to distinguish between legitimate trades and those conducted in connection with inside information." *Ibid.*

Having reached that conclusion, however, the court went on to suggest that "it is unnecessary to determine whether proof of securities fraud requires a causal connection, because any alleged defect in the instruction was harmless beyond a reasonable doubt." App., *infra,* 19a. The court noted that the instructions on scienter required the jury to find that petitioners knew the David and Salsbury tips involved wrongfully acquired, material nonpublic information. In this setting, the court reached the conclusion that "[i]t strains reason to argue that an arbitrageur, who traded while possessing information he knew to be fraudulently obtained, knew to be material, knew

to be nonpublic—and who did not act in good faith in doing so—did not also trade on the basis of that information. We find that on the facts of this case, no reasonable jury could have made such a distinction." *Id.* at 21a.

REASONS FOR GRANTING THE PETITION

This case presents a question of substantial importance to the operation of the nation's securities markets. The decision below is grounded on the so-called "misappropriation theory" of securities fraud, a doctrine of doubtful provenance that has never been approved by this Court. And in building upon that theory to conclude that a defendant may be convicted of an insider trading violation *even when he did not use inside information in his trades,* the court of appeals enormously expanded the reach of the securities laws' antifraud proscriptions. In taking that step, the court called into question the legality of market practices that are both ubiquitous and socially beneficial. Because the analysis used below also cannot be reconciled with decisions of this and other courts—and because the Second Circuit's pronouncements on securities law have national importance—further review is warranted.

A. The Court of Appeals' Misappropriation Theory of Securities Fraud Finds No Support in This Court's Decisions

1. This Court's seminal decisions defining insider trading, *Chiarella* v. *United States,* 445 U.S. 222 (1980), and *Dirks* v. *SEC,* 463 U.S. 646 (1983), set out what is sometimes called the " 'classical' theory of Rule 10b-5 liability." *SEC* v. *Clark,* 915 F.2d 439, 443 (9th Cir. 1990). Relying on common law notions of fraud (see 445 U.S. at 227-228 & n.9, 233), *Chiarella* held that liability for trading on inside information "is premised upon a duty to disclose arising from a relationship of trust and confidence *between parties to a transaction.*" *Id.* at 230 (emphasis added). Under this approach, a corporate insider violates a duty to the shareholders of his corpora-

tion when he uses inside information to trade *in that corporation's shares.* See *id.* at 227-229. *Dirks* refined this rule, holding that the tippee of a corporate insider could also be liable, if "the tippee knew the information was given to him in breach of a duty *by a person having a special relationship to the issuer* not to disclose the information." 463 U.S. at 661 (emphasis added) (internal quotations and citation omitted).

In this case, however, there was no allegation that petitioners (or anyone else) violated a duty to the issuers or sellers of the securities that were traded.[5] The prosecution here proceeded on an entirely different ground: petitioners were charged under the so-called "misappropriation theory" of securities fraud. "In contrast to *Chiarella* and *Dirks,* the misappropriation theory does not require that the buyer or seller of securities be defrauded." *United States* v. *Chestman,* 947 F.2d 551, 566 (2d Cir. 1991) (en banc), cert. denied, 112 S. Ct. 1759 (1992). Instead, such a fraud is said to occur whenever *anyone's* confidential information is misappropriated for use in trading. The theory accordingly applies when the information is misappropriated—as in this case—from entities that simply provided investment advice, such as Paul Weiss and Drexel; it applies when the information is stolen from a financial printer (see, *e.g., SEC* v. *Materia,* 745 F.2d 197 (2d Cir. 1984), cert. denied, 471 U.S. 1053

[5] As the district court informed the jury:

> The government does not charge in this case that the persons from whom the defendants purchased stocks were themselves defrauded by the nondisclosure of whatever material nonpublic information defendants are alleged to have obtained. This indictment charges that the alleged conspirators defrauded not the sellers of the target companies' stock, but rather the law firm of Paul Weiss and its corporate clients, the clients of Drexel Burnham, and in the case of Revco, the persons who entrusted the information concerning Revco to Marcus Schloss & Company.

J.A. 1616-1617.

(1985)); it applies even when (as in the notorious case of former Wall Street Journal columnist R. Foster Winans) the entity from which the information was taken (there, the Journal) does not participate in market activities at all. See *United States* v. *Carpenter*, 791 F.2d 1024 (2d Cir. 1986), aff'd in relevant part by an equally divided Court, 484 U.S. 19 (1987).

The misappropriation theory has been embraced most firmly by the Second Circuit, which has applied it repeatedly over the last decade.[6] It has been endorsed more recently by the Seventh and Ninth Circuits. See *SEC* v. *Cherif*, 933 F.2d 403 (7th Cir. 1991), cert. denied, 112 S. Ct. 966 (1992); *SEC* v. *Clark*, *supra*.[7] It has not, however, been approved by this Court. To the contrary, the propriety of the theory was expressly left open in *Chiarella*. See 445 U.S. at 236-237; *id.* at 238 (Stevens, J., concurring). And the Court divided four-to-four on the question in *Carpenter*. See 484 U.S. at 24.

Not surprisingly, "experts in securities law have disagreed about the viability of the misappropriation theory after the *Carpenter* decision." Aldave, *The Misappropriation Theory:* Carpenter *and its Aftermath*, 49 Ohio St. L.J. 373, 375 (1988). See Olson, Sturc & Lins, *Recent Insider Trading Developments: The Search for Clarity*, 85 Nw. U. L. Rev. 715, 731 (1991) (misappropriation

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[6] See, *e.g.*, *United States* v. *Carpenter*, *supra*; *SEC* v. *Materia*, *supra*; *United States* v. *Newman*, 664 F.2d 12 (2d Cir. 1981), cert. denied, 464 U.S. 863 (1983).

[7] In addition, in *Rothberg* v. *Rosenbloom*, 771 F.2d 818, 822 (3d Cir. 1985), the court held that "[a]n insider on either side of a proposed transaction violates the insider trading rule when he uses inside information in violation of the fiduciary duty owed to the corporation to which he owes a duty of confidentiality." Although this expands upon *Chiarella* and *Dirks*, the court did not in terms adopt the misappropriation theory and appears to have limited its holding to those who violate a "fiduciary duty to either party of the underlying proposed transaction." *Ibid.* See *id.* at 825 (Higginbotham, J., concurring).

theory "left in limbo" after *Carpenter*). A committee of Congress, while speaking favorably of the theory, also has acknowledged that the doctrine's validity "is unresolved nationally" after *Carpenter*. H.R. Rep. No. 910, 100th Cong., 2d Sess. 10 (1988) (reporting on the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677). Congress itself has not acted by legislation either to codify the misappropriation theory, to reject it, or otherwise to define the insider trading violation.

The reason for this uncertainty about the status of the theory—and, perhaps, for the Court's reluctance to embrace it—is easy to understand: the misappropriation doctrine is entirely without foundation in this Court's prior interpretations of the securities laws. *Chiarella* and *Dirks* defined the insider trading offense as involving a fraud on the seller or purchaser of securites. See *Chiarella*, 445 U.S. at 232. And they found the fraud in the breach of duty by an insider (or his tippee) that is owed to the shareholders of the corporation in whose shares he trades. See *Dirks*, 463 U.S. at 655 (noting a "requirement of a specific relationship between the shareholders and the individual trading on inside information"). The misappropriation theory, in contrast, is aimed at a fraud that is remote from the securities transaction.

As a consequence, the doctrine has been roundly "criticized in many quarters." Olson, Sturc & Lins, *supra*, at 717. "[M]any in the securities bar believe[] that the misappropriation theory was an unwarranted extension of Rule 10b-5 * * *." *Id.* at 729. Commentators have come to the same conclusion, reasoning that "[c]onceptually, the misappropriation theory is a strained use of Rule 10b-5." Langevoort, *Investment Analysts and the Law of Insider Trading*, 76 Va. L. Rev. 1023, 1034-1035 (1990) (footnote omitted).[8] They have explained that the theory,

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[8] See ABA Comm. on the Federal Regulation of Securities, *Report of the Task Force on Regulation of Insider Trading—Part I:*

whether or not sensible as a matter of policy, "simply does not square well with the doctrinal structure of Rule 10b-5, which seems to speak largely in terms of protecting the integrity of the investment decisions of buyers or sellers of securities." *Id.* at 1035 n.43.

Five judges of the en banc Second Circuit recently joined in this questioning of the misappropriation theory. They noted that "any obvious relationship [of the theory] to Section 10(b) is presently missing"—although they concluded, with some reluctance, that "the law is far enough down this road * * * that a court of appeals has no option but to continue the route." *Chestman*, 947 F.2d at 578 (Winter, J., concurring in part and dissenting in part). The misappropriation theory is thus an exceedingly shaky ground on which to premise petitioners' convictions.

B. Conviction for Securities Fraud Requires Use, Rather Than Simple Possession, of Material Nonpublic Information

The decision below, however, goes well beyond a conventional application of the misappropriation theory. The court of appeals' conclusion that a defendant may be convicted of securities fraud *even when his trade did not involve use of misappropriated information* works an extravagant expansion of the doctrine, and entirely severs an already questionable theory from its roots in the com-

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Regulation Under the Antifraud Provisions of the Securities Exchange Act of 1934, reprinted in 41 Bus. Law. 223, 237 (1985); Langevoort, *Insider Trading and the Fiduciary Principle: A Post-*Chiarella *Restatement*, 70 Cal. L. Rev. 1, 46-48 (1982); Phillips & Intz, *The Insider Trading Doctrine: A Need for Legislative Repair*, 13 Hofstra L. Rev. 65, 91 (1984); Silver, *Penalizing Insider Trading: A Critical Assessment of the Insider Trading Sanctions Act of 1984*, 1985 Duke L.J. 960, 983; Wang, *Trading on Material Nonpublic Information on Impersonal Stock Markets: Who is Harmed, and Who Can Sue Whom Under SEC Rule 10b-5*, 54 S. Cal. L. Rev. 1217, 1272 (1981).

mon law of fraud. Cf. *McNally* v. *United States*, 483 U.S. 350, 358-360 (1987) (rejecting "intangible rights" theory of mail fraud). In doing so, it subjects to prosecution a wide range of legitimate conduct and threatens destructive consequences for the nation's securities markets.

1. At the outset, the court of appeals' finding that a trader commits fraud even when not using the misappropriated information in his possession is inconsistent both with common law notions of fraud that have been recognized by this Court and with other circuits' understanding of the fraud concepts that underlie the misappropriation theory in particular. "[T]he words 'to defraud' commonly refer 'to wronging one in his property rights * * *,' and 'usually signify the deprivation of something of value * * *.'" *McNally*, 483 U.S. at 358, quoting *Hammerschmidt* v. *United States*, 265 U.S. 182, 188 (1924). See *Carpenter*, 484 U.S. at 25-26. The property interest at issue here is that in confidential information. And as the Court made clear in *Carpenter*, where it held that the misuse of confidential information may violate the mail and wire fraud statutes, the value of proprietary information consists in the owner's "right to exclusive use of the information." *Id.* at 26-27. See *International News Serv.* v. *Associated Press*, 248 U.S. 215, 239-242 (1918); Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 Sup. St. Rev. 309, 331. It follows that a party who receives material nonpublic information but who trades on some other basis has not deprived the owner of anything of value—and therefore has not committed fraud.

The Seventh and Ninth Circuits reached just that conclusion in expressly determining that the misappropriation theory requires the *misuse* of wrongfully acquired information. As the Seventh Circuit explained, quoting the Ninth Circuit's holding in *Clark*:

> There is a common sense notion of fraud behind the misappropriation theory. As the *Clark* court put it: "[B]y becoming part of a fiduciary or similar relationship, an individual is implicitly stating that she will not divulge or use to her own advantage information entrusted to her in the utmost confidence. She deceives the other party by playing the role of trustworthy employee or agent; *she defrauds it by actually using the stolen information to its detriment.*"

Cherif, 933 F.2d at 410, quoting *Clark*, 915 F.2d at 448 (emphasis added).[9] Indeed, the government said as much in its brief to this Court in *Carpenter*, declaring that a scheme to defraud must "contemplate[] some sort of harm to the victim" and that under the misappropriation theory the fraud is "the misappropriation of information *for the purpose of trading*." No. 86-422, U.S. Br. 14, 37 (emphasis added).[10] Someone who possesses but does not trade on misappropriated information thus, very simply, does not commit fraud. And while "Section 10(b) is aptly described as a catchall [antifraud] provision, * * *

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[9] The Ninth Circuit added: "the [misappropriation] theory provides that Rule 10b-5 is violated when a person (1) misappropriates material nonpublic information (2) by breaching a duty arising out of a relationship of trust and confidence and (3) *uses that information in a securities transaction*, (4) regardless of whether he owed any duties to the shareholders of the traded stock." *Clark*, 915 F.2d at 443 (emphasis added).

[10] As one of the leading proponents of the misappropriation theory has explained:

> Because a fraud is not complete until someone is injured, the fraud committed by the *Carpenter* defendants did not consist solely of the misappropriation of confidential information from the *Journal*. Neither the *Journal* nor any other person would have been harmed if Winans had simply taken a copy of the *Journal*'s publication schedule home with him and locked it in a strong box. * * * Rather, the fraud consisted of Winans' misappropriation of the *Journal*'s confidential information *and* the defendants' subsequent trading on that information.

Aldave, *supra*, at 378 (footnote omitted).

what it catches must be fraud." *Chiarella*, 445 U.S. at 234-235.[11]

2. It thus comes as no surprise that, as a leading commentator has writen of the decision below, "the possession standard represents a departure from pre-existing reliance on a 'use' test." Pitt & Groskaufmanis, *Actual Use of Inside Information at Issue*, Nat. L. J., June 21, 1993, at 20, 22. In fact, the court of appeals' approach is inconsistent with what had been the nearly universal understanding—shared by this and other courts, practitioners, and commentators—that use rather than possession is the proper test for securities fraud liability.

This Court, for example, repeatedly and consistently has described the activity proscribed by the restrictions on insider trading as "*using* undisclosed corporate information" and "*exploiting* the information for * * * personal gain." *Dirks*, 463 U.S. at 659 (emphasis added). See *id.* at 667 (duty to "abstain from use of the inside information"); *Chiarella*, 445 U.S. at 229 ("[t]he federal courts have found violations of § 10(b) where corporate insiders used undisclosed information for their own benefit"); *id.* at 230 ("fraudulent use"); *id.* at 239 (Brennan, J., concurring in the judgment) ("a person violates § 10(b) whenever he improperly obtains or converts to his own benefit nonpublic information which he then uses in connection with the purchase or sale of securities"); *id.* at 241 (Burger, C.J., dissenting) (purchase of securities "on the basis of misappropriated nonpublic information"); *id.* at 249 (Blackmun, J., dissenting) ("misuse of secret knowledge as the gravamen of illegal conduct").

Other courts have done the same. See, *e.g.*, *Raiford* v. *BusLease, Inc.*, 825 F.2d 351, 354 (11th Cir. 1987) (insider "may not use [inside] information in connection with the purchase or sale of securities to take advantage

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[11] For the same reason, of course, the mail fraud statute is inapplicable in such circumstances. See generally *McNally*, 483 U.S. at 358-360.

of his knowledge"); *Rothberg*, 771 F.2d at 822 (insider "violates the insider trading rule when he uses inside information"); 5C A. Jacobs, *Litigation and Practice Under Rule 10b-5* § 66.02[c], at 3-657 n.64 (1992) (citing cases). Leading commentators agree that "an insider's or tippee's decision to buy or sell must be based on his inside information" for liability to arise. *Id.*, § 66.02[c], at 3-657. See *id.*, § 66.02[c], at 3-661 ("A finding that an insider or tippee had the inside information when he bought or sold is not dispositive of whether he traded on the basis of that information"); 3 A. Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud* §§ 7.4(610), 7.4(620), 7.4(621) (1992) ("far more cases speak in terms of use" and if possession rather than use is "the element of the violation * * * nonuse appears to be an affirmative defense"); Note, *A Critique of the Insider Trading Sanctions Act of 1984*, 71 Va. L. Rev. 455, 494-495 (1985).[12]

Indeed, when the nation's leading securities practitioners testified before Congress on precisely this question in 1983 and 1984, they were unanimous in concluding that under existing law use rather than possession of misappropriated information is the standard for establishing the insider trading offense. As one group explained: "the critical conduct is not the purchase or sale of a security 'while in the possession' of material non-public information; rather, it is the purchase or sale of a security 'on the basis' of material non-public information. * * * Rule 10b-5 should not presently be interpreted as providing a remedy for trading 'while in the possession' of material nonpublic information * * *." *Insider Trading Sanctions and SEC Enforcement Legislation: Hearings on H.R. 559 Before the Subcomm. on Telecommunications, Con-*

[12] Professor Loss suggests that possession is the proper standard but acknowledges that "[a] number of cases use language that seems to look the other way." 7 L. Loss & J. Seligman, *Securities Regulation* 3504 (3d ed. 1991). For reasons we explain below, his principal reason for supporting a possession test—the difficulty of proving use (see *id.* at 3505)—is insupportable.

sumer Protection & Finance of the House Comm. on Energy & Commerce, 98th Cong., 1st Sess. 296-297 (1983) ("*House Hearings*") (statement of the Comm. on Securities Regulation of the New York State Bar Association). See *id.* at 315-316 (statement of ABA Comm. on Federal Regulation of Securities) (liability is "limited to those who use [inside] information"); *id.* at 196-197 (statement of Arnold S. Jacobs on behalf of the Comm. on Securities Regulation of the New York City Bar Association) ("The trade must be based on inside information"); *The Insider Trading Sanctions Act of 1983: Hearings on H.R. 559 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing & Urban Affairs*, 98th Cong., 2d Sess. 116 (1984) ("*Senate Hearings*") (statement of Faith Colish, chair of the Comm. on Securities and Exchanges of the New York County Lawyers Association) ("it is important to distinguish between possession and use of the information"); *id.* at 111 (statement of the Comm. on Securities Regulation of the New York State Bar Association) (liability limited to those who trade " 'on the basis' of material nonpublic information"); *id.* at 103 (personal statement of Arnold S. Jacobs) (basing liability on possession "is an incorrect statement of the existing law. Rather, a person is prohibited from trading only 'on the basis' of inside information").[13]

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[13] The only reservations on this point were expressed by the SEC, which exhibited some confusion about the proper standard. The SEC's general counsel and director of enforcement respectively testified that "the Commission's position * * * has been that possession of material inside information is the test" and that "I know of no decision where a court has abandoned the 'in possession' theory." *House Hearings* 48-49. The SEC's chairman, however, stated that "in terms of court decisions, I am not sure that we have always won on that ground," adding that when one member of a financial firm possesses information while another trades, the trader "may not be acting on inside information." *Id.* at 49.

This confusion may reflect a historic inconsistency in the Commission's approach. The Commission initially declared it a necessary element of securities fraud "that the information be a factor

Similarly, when a group of leading securities law practitioners (chaired by a former SEC general counsel) was commissioned by members of the Senate Banking Committee to draft a definition of insider trading, they proposed including a *rebuttable* presumption that persons who possess inside information while trading have used it. S. 1380, 100th Cong., 1st Sess. (1987). See Olson, Sturc & Lins, *supra*, at 728. This standard was described as a codification of existing law. See *Hearings on S. 1380 Before the Subcomm. on Securities of the Sen. Comm. on Banking, Housing & Urban Affairs*, 100th Cong., 1st Sess. 16-40 (1987) (statement of Harvey Pitt).

3. Against this, the court of appeals' reasons for adopting a possession standard plainly lack substance. The court noted, first, that the "in connection with" clause of Rule 10b-5 has been construed flexibly to encompass " 'fraud * * * perpetrated on the source of the nonpublic information, even though the source may be unaffiliated with the buyer or seller of securities.' " App., *infra*, at 18a (citation omitted). But this observation, which merely describes the misappropriation theory, begs

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in [the defendant's] decision to effect the transaction." *In re Investors' Management Co.*, 44 S.E.C. 633, 641 (1971) (footnote omitted). See *id.* at 650 (Commissioner Smith, concurring in the result) ("[t]he Commission's staff in this case, and in *Cady Roberts*[, 40 S.E.C. 907 (1961)] and [*SEC* v.] *Texas Gulf* [*Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), cert. denied, 404 U.S. 1005 (1971)], accepted the burden of proving that the inside information was the motivating factor, and not just a factor, in the decision to effect the transaction.") But the Commission has since reversed course, endorsing a possession standard. See *Report of Investigation in re Sterling Drug, Inc.*, 14 S.E.C. Docket 824, 827 (1978). Although the conclusion in *Sterling* appears to have been based on the "parity of information" theory that has since been rejected by this Court (see *Dirks*, 463 U.S. at 654-655, 657-658; *Chiarella*, 445 U.S. at 233), the SEC has not retreated from its position. This is just one of a number of areas where the SEC "seems to take a somewhat more expansive view of what is illegal than the courts." *Chestman*, 947 F.2d at 572 (Winter, J., concurring in part and dissenting in part).

the question whether that theory applies in the absence of a fraudulent deprivation of a property interest in exclusive use of the misappropriated information.

Second, the court believed that a possession standard comports with the "disclose or abstain" rule that governs insiders. App., *infra*, 18a, citing *Chiarella*, 445 U.S. at 227. Again, however, this begs the question: must the defendant in that situation abstain from trading *at all*, or (as the rule is usually formulated) abstain from trading *on the basis* of the misappropriated information? In fact, this Court's analysis suggests that the latter is the proper formulation. As it has explained, the disclose or abstain requirement is grounded on " 'the unfairness of allowing a corporate insider *to take advantage of that information* by trading without disclosure.' " *Dirks*, 463 U.S. at 653-654, quoting *Chiarella*, 445 U.S. at 227 (emphasis added). Thus, "[a]pplication of a duty to disclose prior to trading guarantees that corporate insiders * * * will not benefit personally *through fraudulent use* of material, nonpublic information." *Chiarella*, 445 U.S. at 230 (emphasis added) (footnote omitted). This rationale has no application when the decision to trade has some other basis.

The court also erred in concluding (App., *infra*, 18a-19a) that a noncausation rule is justified by difficulties of proof. The courts and the SEC have applied a rebuttable inference that a defendant traded on the basis of material nonpublic information when he possessed the information and traded in a manner consistent with it. See *Dura-Bilt Corp.* v. *Chase Manhattan Corp.*, 89 F.R.D. 87, 95 (S.D.N.Y. 1981); *Investors Management*, 44 S.E.C. at 646-647; Jacobs, *supra*, § 66.02[c], at 3-661. With that done, "the difficulties of proof have not been insuperable. Indeed the SEC and private plaintiffs have commonly prevailed in court on the issue." Bromberg & Lowenfels, *supra*, § 7.4(622), at 7:160.15. An SEC Commissioner thus has observed that establishing use "is evidently not an unduly difficult [burden] to meet in the

proper case" (*Investors Management*, 44 S.E.C. at 650 (Commissioner Smith, concurring in the result)). See *House Hearings* 49 (testimony of SEC general counsel that it would be "difficult" for a defendant to show proper purpose if defendant traded while in possession of inside information). If that is so, it cannot be the case that difficulties of proof justify an *irrebuttable* presumption to that effect.[14] To the contrary, while defendants often may find it difficult to show that they were not influenced by inside information, those who can make the showing surely are entitled to do so. Finally, it simply is not part of the traditional American criminal law to cast aside legitimate defenses simply to facilitate the prosecution's task in obtaining convictions.

4. The Second Circuit's endorsement of a possession standard will have profoundly important practical effects that may require "a reassessment of some of the basic operating principles of the securities markets." Pitt & Groskaufmanis, *supra*, at 22. Those consequences are most apparent for market analysts and arbitrageurs. As we have explained (at 3), the analyst's information-seeking activity is of great value to a properly functioning market. "[B]ecause analysts have a comparative advantage over investors in interpreting, verifying and seeking out information," their efforts reduce transaction costs and promote efficient trading. Fischel, *Insider Trading and Investment Analysts: An Economic Analysis of Dirks v. Securities and Exchange Commission*, 13 Hofstra L. Rev. 127, 142 (1984). See Gilson & Kraakman, *The*

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[14] In *Dirks*, where the Court held that an insider's disclosure of corporate information breaches a fiduciary duty only when the insider personally benefits from the disclosure, the Court rejected an argument almost identical to that relied upon by the court below. There, the SEC contended that "it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information." 463 U.S. at 633. But the Court held that "the SEC is unduly concerned," explaining that "[t]here are objective facts and circumstances that often justify" an inference of personal benefit. *Id.* at 664.

Mechanisms of Market Efficiency, 70 Va. L. Rev. 549, 569-579 (1984). Moreover, aggressive information-seeking by analysts, including arbitrageurs, benefits not only their clients but the market as a whole. For "the sooner [undisclosed information] is found, the more accurately it is appraised, and the more immediately it induces a purchase or sale, the more precisely will the market price of the securities correspond to the value of the enterprise." Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 322, 341 (1979).

Analysts accordingly have been urged both by the stock exchanges themselves [15] and by the SEC to "obtain as much information—including rumors—regarding a security as they can so that they may properly advise their clients." *SEC* v. *Monarch Fund*, 608 F.2d 938, 942 (2d Cir. 1979). The Commission recognizes that "analysts actively seek out bits and pieces of corporate information not generally known to the market," on the basis of which "their clients * * * can be expected to trade." *In re Dirks*, 21 S.E.C. Docket 1401, 1406 (1981), aff'd, 681 F.2d 824 (D.C. Cir. 1982), rev'd on other grounds, 463 U.S. 646 (1983). In the Commission's view, "[t]he value to the entire market of these efforts cannot be gainsaid." *Ibid.* See *Investors Management*, 44 S.E.C. at 646; *id.* at 649 (Commissioner Smith, concurring in the result). The Commission thus *encourages* analysts to seek out, and corporate insiders and their agents to disclose, "non-public, inside information which in itself is immaterial" but which an analyst, applying his special expertise, can combine with publicly available information "to form a 'mosaic' which is * * * material." *Dirks*, 21 S.E.C. Docket at 1409. This Court, of course, has endorsed that conception of the analyst's role. See page 3, *supra*.

The decision below, however, will dramatically change the analysts' equation. Because "materiality" is "one of

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[15] See *SEC* v. *Bausch & Lomb Inc.*, 565 F.2d 8, 9 (2d Cir. 1977).

the most unpredictable and elusive concepts of the federal securities laws" (*Bausch & Lomb*, 565 F.2d at 10), it is inevitable that analysts and arbitrageurs who seek to confirm the significance of their analysis of public information will inadvertently (even unwittingly) uncover material nonpublic information. Forcing analysts in this recurring situation to refrain from acting upon the basis of their own research would systematically deprive the market of desirable information-seeking and analysis. It also would lead analysts and arbitrageurs to scale back their efforts, an outcome that would further dampen the flow of useful information into the market. See Note, *supra*, 71 Va. L. Rev. at 495.

Beyond that, the Second Circuit's possession standard will have consequences for a wide range of routine—and useful—market activities. For one, as a leading practitioner explained in describing the undesirability of a possession standard, there is the example

> of a marketmaker who day after day trades thousands and thousands of shares of stock as a wholesaler, as a financial intermediary. If that marketmaker were to come upon some truly inside information, should he necessarily be inhibited from continuing to make a market? I don't think so. I don't think his trading is "on the basis" of his inside information.

Senate Hearings 116 (statement of Faith Colish).[16]

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[16] Another leading practitioner has noted that the decision below calls the propriety of such market-making activities into question. He explained:

> In the over-the-counter market, a market maker maintains bid and offer prices in a given company's securities and, like a specialist on a stock exchange, helps maintain an orderly market in those securities. Firms continue this trading [after receiving inside information] on the rationale that it is passive in that the firm reacts to customer demands, maintains market liquidity and that a withdrawal from market-making activity

Similarly, one department of a multi-service financial firm may trade in a security even though persons in another department (such as an investment banking division) possess inside information; "[a]lthough the firm is 'in possession' of material nonpublic information, the trades are not made 'on the basis of' the prohibited information and therefore are not unlawful under existing law." *Senate Hearings* 126 (statement of Sam Scott Miller on behalf of the Securities Industry Association). Firms typically use "Chinese Walls" to preclude the misuse of confidential information in this situation. See Pitt & Groskaufmanis, *supra,* at 22.[17] But the endorsement of a possession standard by the decision below calls into question the legality of that approach. See Note, *supra,* 71 Va. L. Rev. at 494-495. As a consequence, "*Teicher* casts a shadow over industry conventions that have focused on what steps were taken to ensure that the information was not used in making an investment decision. * * * [T]he prospect of a possession standard will generate a litany of day-to-day issues * * *." Pitt & Groskaufmanis, *supra,* at 22.

And the court of appeals' analysis raises grave doubts about the propriety of a variety of other workaday practices in which persons trade despite their possession of material nonpublic information. Until now, for example, it had been generally thought that "Rule 10b-5 imposes

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would only serve to tip the marketplace about the existence of some material, non-public information.

Pitt & Groskaufmanis, *supra,* at 22. The SEC has agreed that restrictions on market making after the market maker comes into possession of inside information would damage both confidentiality of information and market liquidity. See SEC, Division of Market Regulation, *Broker-Dealer Policies and Procedures Designed to Segment the Flow and Prevent the Misuse of Material Non-Public Information,* [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,520, at 80,622.

[17] The Commission has provided by regulation for Chinese Walls under Rule 14e-3(b)(2) but has not done so under Rule 10b-5.

'no obligation to pull back from a commitment previously made by the buyer and accepted by the seller because of after-acquired knowledge.'" *Sundstrand Corp.* v. *Sun Chemical Corp.*, 553 F.2d 1033, 1050 (7th Cir.) (citation omitted), cert. denied, 434 U.S. 875 (1977). See *Raiford*, 825 F.2d at 354. Similarly, it had not been believed that the receipt of inside information required departure from a consistent past pattern of purchases or sales. See, *e.g.*, *Freeman* v. *Decio*, 584 F.2d 186, 197 n.44 (7th Cir. 1978). And it had been assumed that persons facing unforeseen emergencies requiring the liquidation of assets were not disabled from doing so because they were in possession of inside information. See A. Jacobs, *supra*, § 66.02[c], at 3-663. Those understandings cannot survive under the court of appeals' analysis.

5. Finally, the decision below should not be insulated from review by the court of appeals' recitation of "harmless error" as a basis for affirming petitioners' convictions. In fact, the court's reliance on harmless error was wholly illusory. The court did not base its conclusion on anything unique to the record in this case. Instead, it simply observed that the jury had been duly instructed on scienter, meaning that the jurors had to find that petitioners knowingly possessed material nonpublic information and did not act "in good faith." App., *infra*, 20a-21a. Having made such a finding, the court held, "no reasonable jury" could have concluded that petitioners did not use the information in their trades. *Id.* at 21a.

This analysis, however, has the effect of altogether reading any use requirement out of Section 10(b) and Rule 10b-5, and Section 14(e) and Rule 14e-3. In *every* prosecution under the statute and Rules the jury will have to find scienter to convict. And such a finding, the court below held, carries with it a *conclusive* presumption of use. The practical effect of this holding, of course, is that the government never will have to prove more than possession. The court's conclusions regarding the merits and

harmless error thus were not analytically distinct; if this Court holds that use of the information is an element of the fraud offense that must be separately proved, the court of appeals' harmless error analysis cannot stand.

In addition, the decision below plainly is a dispositive treatment of the possession question. Future panels of the Second Circuit hardly can be expected to depart from the considered analysis of the possession requirement offered by the court in this case. The decision thus "alters the environment in which judgments of risk are made." Pitt & Groskaufmanis, *supra,* at 22.

That is especially so because both the SEC and the Justice Department—speaking through the U.S. Attorney for the Southern District of New York [18] (see C.A. Br. 35-41)—have expressly endorsed possession as the proper standard. Participants in the securities markets thus should expect to risk criminal prosecution and civil enforcement actions for trading while in possession of inside information even though it is not the basis for their trades—and also, in light of the decision below, can expect to have their convictions upheld. As a consequence, prudent participants in the market will have no choice but to conform their conduct to the standard stated by the court in this case. Indeed, the impact of the decision below already may be seen. As a leading practitioner and commentator has explained, "[t]he impact of the *Teicher* opinion will be felt most profoundly not in litigation but in the day-to-day efforts of market participants—from

[18] The positions taken by that office carry special force in this area of the law. The U.S. Attorney's office in the Southern District of New York is the only one in the nation that has a specialized unit for securities fraud. In addition, of course, the SEC's enforcement activities are concentrated in New York, both because it is a national center of financial activity and because, as the location of the principal national stock exchanges, jurisdiction based on "use of any facility of any national securities exchange" (15 U.S.C. 78j(b)) most naturally lies there for any Rule 10b-5 action involving publicly traded securities.

securities professionals to those associated with public companies of all sizes—to avoid trades that, in hindsight, cross the murky line into illegality." Pitt & Groskaufmanis, *supra*, at 20. Because the court of appeals' decision accordingly is of great importance, review by this Court is in order.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JULY 1993

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 735, 736—August Term, 1992

(Argued: December 21, 1992
Decided: March 2, 1993)

Docket Nos. 92-1301, -1302

UNITED STATES OF AMERICA, APPELLEE

—*v.*—

VICTOR TEICHER, VICTOR TEICHER & CO., L.P.
AND ROSS FRANKEL, DEFENDANTS-APPELLANTS

Before:

PIERCE, ALTIMARI and WALKER,
Circuit Judges.

Appeal from judgments of conviction entered in the United States District Court for the Southern District of New York (Haight, *Judge*), convicting defendants of violations of the securities laws for insider trading.

Affirmed.

ANDREW L. FREY, Washington, D.C. (Dan M. Kahan, Mayer, Brown & Platt, Washington, D. C., of counsel) for *Defendants-Appellants Victor Teicher and Victor Teicher & Co.*

ROGER J. BERNSTEIN, New York, N.Y. (Caryn M. Hirshleifer, New York, N.Y., of counsel) for *Defendant-Appellant Ross Frankel.*

JOHN W. AUCHINCLOSS II, Assistant United States Attorney, Southern District of New York (Roger S. Hayes, Acting United States Attorney, Southern District of New York, John K. Carroll, Reid M. Figel, Assistant United States Attorneys, Southern District of New York) for *Appellee.*

ALTIMARI, *Circuit Judge*:

Defendants-appellants Victor Teicher, Victor Teicher & Co., L.P., and Ross Frankel appeal from judgments of conviction entered in the United States District Court for the Southern District of New York (Charles S. Haight, Jr., *Judge*) following a twelve week jury trial. Teicher and Victor Teicher & Co., L.P. (collectively the "Teicher defendants") were convicted on nine counts of securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff, 17 C.F.R. § 240.10b-5 ("Rule 10b-5"), and 18 U.S.C. § 2; two counts of fraud in connection with a tender offer in violation of 15 U.S.C. §§ 78n(e) and 78ff, 17 C.F.R. § 240.14e-3 ("Rule 14e-3"), and 18 U.S.C. § 2; and one count of conspiracy to violate the securities laws and anti-fraud laws, in violation of 18 U.S.C. § 371. Teicher was also convicted on two counts of mail fraud in violation of 18 U.S.C. §§ 1341 and 2.

Frankel was convicted on one count of securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff, Rule 10b-5, and 18 U.S.C. § 2; one count of mail fraud in violation of 18 U.S.C. §§ 1341 and 2; one count of conspiracy to violate the securities laws and anti-fraud laws, in violation of 18 U.S.C. § 371; one count of perjury before the Securities Exchange Commission ("SEC") in violation of 18 U.S.C. § 1621; and, two counts of obstruction of justice in violation of 18 U.S.C. §§ 1505 and 2.

The convictions were the result of an investigation into the trading activities of Teicher in eight separate securities and Frankel in one security after having received material non-public information concerning these securities. Frankel's additional convictions for perjury and obstruction of justice arose from his attempt to conceal his actions which included the destruction of documents pertaining to his trade and his misrepresentations under oath to the SEC. Teicher and Frankel appeal alleging that various errors deprived them of a fair trial.

For the following reasons, the judgments of conviction are affirmed.

BACKGROUND

The players in this case were involved in the business of arbitrage. Arbitrage entails trading in securities in companies that are the subject of changes in corporate control in order to take advantage of fluctuations in the price of these securities. Teicher, an arbitrageur, formed the Victor Teicher & Co., L.P. investment firm through which he managed investment pools for individual investors. Frankel was a research analyst in the arbitrage department of Drexel Burnham Lambert, Inc. ("Drexel").

Robert Salsbury, a key government witness, worked under Frankel performing financial analyses in the research unit at Drexel. During the same period, Michael David, another key government witness and a close personal friend of Salsbury, worked as an associate in the corporate department of the law firm of Paul, Weiss, Rifkind, Wharton & Garrison ("Paul Weiss"). Like Frankel and Teicher, David was interested in arbitrage.

The government's evidence at trial showed that from December 1985 until March 1986, David regularly provided Salsbury and Teicher with information that David had uncovered concerning possible acquisitions by Paul Weiss clients. David also provided Andrew Solomon, a trader at the brokerage firm of Marcus Schloss, Inc. ("Marcus Schloss") with the same Paul Weiss information he had disclosed to Teicher and Salsbury. Solomon, in turn, provided other confidential information to David who then passed it on to Teicher. The government's evidence also demonstrated that Salsbury had provided Teicher with the names of companies on Drexel's "phantom list"—a highly confidential list of companies that were the subject of mergers or takeovers by Drexel clients and in which trading by Drexel personnel was prohibited.

Because the factual background underlying the crimes is complex, we present it in some detail.

I. *The Targeted Acquisitions of Paul Weiss Clients*

a. *The Triangle Industries bid for American Can*

The first tip from David was passed in early February 1986 and involved a possible takeover attempt by Paul Weiss client Triangle Industries of Ameri-

can Can Corporation. David had learned that Triangle Industries was studying the feasibility of the takeover in light of antitrust barriers and that it would occur, if at all, within six months. The information had been given to David by a fellow associate at Paul Weiss. Soon after learning this information, David tipped Teicher that he "had learned within Paul Weiss that American Can at sometime in the future may become a takeover target by a Paul Weiss client, Triangle Industries" and that "if it would happen at all it would happen within six months." David passed along "approximately the same" information to Salsbury and Solomon, among others.

On February 6, 1986, Teicher bought 5,000 shares of American Can common stock and hedged his position by selling 50 call options on the stock. The following day, Teicher "unwound" the transaction by selling the shares and purchasing 50 call options for a one-day trading profit of $1,862.

Salsbury had passed David's information to Frankel. Although no public announcements were made, the price of American Can stock rose sharply, possibly as a result of increased trading activity following David's tipping. According to Salsbury, Frankel was impressed with the increased trading volume and price and urged Salsbury to continue obtaining information from David.

b. *The Dominion Textile bid for Avondale Mills*

The second tip from David involved a takeover attempt by Paul Weiss client Dominion Textile Inc. for control of Avondale Mills, which was also targeted for acquisition by two other companies. After learning from a corporate librarian that there had been

significant activity concerning Avondale Mills, David leafed through the corporate librarian's notebooks and learned of requests for SEC filings and other documents concerning Avondale Mills on behalf of client Dominion Textile. David also learned that Dominion Textile officers were meeting in a Paul Weiss conference room.

On February 21, 1986, David telephoned Teicher and told him that "Dominion Textile is going to make a bid for Avondale Mills." Later that day, Teicher placed an order for 20,000 shares of Avondale stock but was only able to purchase 3,500. On the same day, David tipped Salsbury, who relayed the information to Frankel, and also tipped Solomon who relayed the tip to his boss at Marcus Schloss. Marcus Schloss also purchased Avondale Mills stock.

Three days later, on February 24, Teicher & Co. purchased 9,400 shares of Avondale stock, and on February 26, Teicher & Co. made its final purchase of 1,800 shares of Avondale Mills stock. The next day, Dominion Textile announced its tender offer for Avondale Mills and Teicher sold all his shares of Avondale Mills for a profit of approximately $37,000.

Following the announcement of a competing tender offer from another bidder offering a higher price, David witnessed Dominion Textile officers meeting "day and night" in a Paul Weiss conference room. From this he correctly surmised that Dominion would be making a second bid. David passed on this information to Teicher, Salsbury and Solomon. According to Salsbury, David also told him that he had learned from an associate at Paul Weiss that Dominion Textile "had room" to increase its bid.

On March 14, 1986, Teicher and Co. accounts purchased 9,300 shares of Avondale Mills stock and also sold 3,000 shares that same day. On March 18, Dominion Textile announced a second tender offer for Avondale Mills stock and Teicher began selling his remaining shares for a final profit of $14,000.

c. *The Ampco-Pittsburgh acquisition of Allegheny International*

In early February 1986, David read an entry in the Paul Weiss librarian's notebook concerning a request by a Paul Weiss partner for SEC filings concerning Allegheny International. David later matched the entry's billing code to Allegheny International and told Teicher that Ampco-Pittsburgh was "looking very closely" at Allegheny International. David also tipped Salsbury, and Solomon. On March 7, 1986, while working at Teicher's office, David noticed a sharp increase in price and volume traded of Allegheny stock. David told Teicher "it must be happening." On the same day, Teicher purchased 10,000 shares of Allegheny stock which were sold on March 10 for a profit of $3,300.

d. *The BAT Industries acquisition of American Brands*

In early February 1986, BAT Industries, a British tobacco company, asked its counsel at Paul Weiss to prepare a recommendation concerning the American antitrust environment in connection with its contemplated acquisition of American Brands, an American tobacco company. By reading a list of new business at Paul Weiss, David learned that BAT Industries was considering an acquisition. He learned that the

target was American Brands from reading the librarian's request notebook. Beginning on March 8, David relayed the information in stages, as he learned it, to Salsbury. On March 10, David tipped Salsbury, Teicher and Solomon that a takeover bid would be made by BAT Industries for American Brands.

Salsbury testified that sometime before March 10 he had advised Frankel that a takeover of American Brands was contemplated by a Paul Weiss client and that on March 10, he told Frankel that the client was BAT. Also on this day, Salsbury purchased two American Brands options using Frankel's personal Drexel account. Frankel himself purchased 10 call options. Following this purchase, Frankel requested that Salsbury do research on American Brands. Frankel made additional purchases of American Brands options on March 13, and on March 25.

On March 10, Teicher purchased 10,200 shares of American Brands and allowed David to purchase 10 American Brands call options through a Teicher & Co. account. David and Salsbury testified that Teicher would not let David purchase the options in his own name for to do so would be to leave a "smoking gun."

Ultimately, no takeover attempt was made because counsel at Paul Weiss had recommended to BAT Industries that an acquisition would trigger antitrust liability.

II. *The leveraged buyout of Revco*

In February 1986, Marcus Schloss was approached in connection with a leveraged buyout of Revco, D.S. ("Revco"). From its communications with the buy-

out group, officers at Marcus Schloss learned that $35 was the highest price the group would pay for Revco stock. On March 11, 1986, Revco announced the buyout and a delay in trading in the stock. Solomon contacted David, who was working at Teicher's office, and told him to sell short some Revco stock since the pre-opening indication was that the stock would trade high and the buyout group would only go to $35. David relayed the information to Teicher telling him that the price "was supposed to go to 35 and only 35." David testified that he believed he had told Teicher that the source of his information was from Marcus Schloss.

Teicher sold short 5,000 shares of Revco stock which he covered later in the day by purchasing 5,000 shares following a $1 fall in the price of the stock. Teicher realized a profit of $4,900.

III. *The Drexel Phantom List*

In early January 1986, Drexel was hired by Republic Airlines, Inc. in connection with a proposed merger with NWA, Inc., the parent company of Northwest Airlines. Thereafter, Frankel and Salsbury were notified that Republic was added to the Drexel phantom list. Salsbury immediately telephoned Teicher with this information. On January 8, Teicher began purchasing shares in Republic. Teicher ultimately accumulating 23,900 by January 24, when, following the announcement of the merger, Teicher sold his entire position for a profit of $80,000.

In mid-December 1985, Northeast Savings Bank hired Drexel in connection with its contemplated takeover of Westchester Financial Services Corpora-

tion ("Westchester Financial"). After learning that Westchester Financial Services had been added to the phantom list on December 26, 1985, Salsbury passed on this information to Teicher. Teicher purchased 2,000 shares of Westchester Financial stock on January 14 which he sold on February 3 for a $1,500 profit.

In March 1986, Drexel was retained by W Acquisition Corporation to assist in an attempted takeover of Warnaco, Inc. When Warnaco was added to the phantom list on March 13, 1986, Salsbury again tipped Teicher, this time on the instructions of Frankel. On March 14, Teicher purchased 20,000 shares of Warnaco stock which he sold for a profit of $40,000 following Warnaco's announcement of a tender offer.

IV. *The SEC Investigation*

Michael David was arrested on March 26, 1986. The following morning David's roommate called Salsbury at Drexel to tell him that David was missing. That same morning, Salsbury received a call from the SEC during which he was asked "some questions about Michael David, Andy Solomon and American Brands and Avondale Mills stock trading." Salsbury told Frankel about the telephone call and gave Frankel the number of the SEC investigator. Frankel telephoned Drexel's legal counsel and informed him of the SEC's investigation. "Almost simultaneously," Frankel asked Ronald Geffen, a research analyst for Drexel, to retrieve a check and margin slip he had submitted earlier that day to the trading department for a second purchase of American Brands call options for both Frankel and Sals-

bury. Geffen did so and returned with three copies of the margin slip and the check which was unprocessed. Frankel destroyed the margin slip copies and told Salsbury not to trade in American Brands. Although it is unclear whether Frankel returned Salsbury's check to him, Salsbury maintains that it was never cashed.

Frankel then began discussing with Salsbury how they should explain their interest in American Brands. Frankel rehearsed "four reasons" with Salsbury to tell the SEC and Drexel counsel: (1) Ross Frankel's "father had been in the stock in the past;" (2) that "Ross Frankel liked the company;" (3) that Frankel and Salsbury "did some research to justify the purchase of the options on fundamentals;" and, (4) that Frankel "felt the company's image had been tarnished by tobacco litigation [and] that it was undervalued because of that."

On March 28, 1986, Frankel contacted Geffen from Florida and asked that Geffen destroy a page from his desk calendar. Geffen testified that the page on the calendar was dated either March 26 or March 27 and contained a notation about American Brands reminding Frankel "to get a check from Bob." On April 29, 1986, Frankel wrote a memorandum to Drexel's counsel in which he stated that he had first asked Salsbury to do financial research into American Brands on March 10.

Frankel subsequently testified before the SEC and at trial that he had traded on the basis of a long-standing investment interest in American Brands, prior research, and a takeover "rumor" conveyed to him by Salsbury which did not include its source as originating from Paul Weiss. He points out that

another "rumor" of a takeover was published in the *Wall Street Journal* on March 13, the date of his second purchase.

David, Salsbury and Solomon pleaded guilty to conspiracy and related substantive offenses. A thirty-one count indictment was filed against Frankel, Teicher, Victor Teicher & Co., Marcus Schloss & Co., Inc., and D. Ronald Yagoda, a trader at Marcus Schloss. The trial of the Marcus Schloss defendants was severed from that of Teicher and Frankel.

Trial against Teicher and Frankel commenced on January 16, 1990. After various redactions due to the dismissal of certain counts, the indictment presented to the jury contained eighteen counts.

Count one of the indictment charged that from July 1, 1985 to on or about April 30, 1986 defendants Victor Teicher & Co., L.P., Victor Teicher ("the Teicher defendants") and Ross S. Frankel conspired, in violation of 18 U.S.C. § 371, to commit securities fraud, fraud in connection with a tender offer, and mail fraud. Counts two through ten charged the Teicher defendants with securities fraud with respect to certain securities in violation of 15 U.S.C. §§ 78j (b) and 78ff, Rule 10b-5, and 18 U.S.C. § 2. Count eight charged Frankel with securities fraud with respect to one of those securities, American Brands, Inc. Counts eleven and twelve charged the Teicher defendants with fraud with respect to the tender offer by Dominion Textile for Avondale Mills in violation of 15 U.S.C. §§ 78n(e) and 78ff, Rule 14e-3, and 18 U.S.C. § 2. Counts thirteen and fourteen charged Victor Teicher with mail fraud in violation of 18 U.S.C. §§ 1341 and 2. Count fifteen charged Frankel with mail fraud in violation of 18 U.S.C.

§§ 1341 and 2. Count sixteen charged Frankel with four specifications of perjury before the SEC in violation of 18 U.S.C. § 1621. Counts seventeen and eighteen charged Frankel with obstruction of justice in violation of 18 U.S.C. §§ 1505 and 2.

On April 6, 1990, the jury returned a verdict of guilty on all counts. Teicher and Frankel now appeal contending, *inter alia*, that the district court improperly excluded evidence of bias by a government witness and, that the district court improperly charged the jury as to the necessary elements of a securities violation.

DISCUSSION

I. *Salsbury's Religious Beliefs*

Both Teicher and Frankel contend that the district court improperly limited their attempts to impeach Salsbury by demonstrating that he was biased against Jews. Their objection stems from what Salsbury termed "religious thoughts" he had after his arrest but prior to testifying. Outside the presence of the jury, Salsbury testified before Judge Haight that he had a long interest in "Jewish thought, particularly cabalistic thought," and that after he saw the fall of himself and other talented Jewish traders "in the field of making a lot of money" that he came to believe that "there is something to be said for messianic thought." Salsbury concluded that he and other Jewish traders "worshipped money too much and false gods or false messiahs" and "that perhaps there would be repercussions."

Federal Rule of Evidence 610 provides:

> Evidence of the beliefs of opinions of a witness on matters of religion is not admissible for the

> purpose of showing that by reason of their nature the witness' credibility is impaired or enhanced.

The rule proscribes the impeachment of witness based upon their religious beliefs. *See United States v. Kalaydjian*, 784 F.2d 53, 56 (2d Cir. 1986). However, inquiry into religious beliefs "for the purpose of showing interest or bias because of them is not within the prohibition." Fed. R. Evid. 610, advisory committee's note; *see also United States v. Hoffman*, 806 F.2d 703, 708 (7th Cir. 1986), *cert. denied*, 481 U.S. 1005 (1987).

In order to ascertain whether Salsbury's views were probative of bias, Judge Haight asked Salsbury whether anything in his religious views made him feel that he should help in the prosecution of the defendants. Salsbury answered that he did not feel that way and, in fact, did not wish to testify. Salsbury offered three reasons for his reluctance: first, it caused him personal disruption and aggravation; second, he considered the Teicher family his friends; and, third, because "one of the cardinal rules is . . . Jews aren't supposed to turn other Jews over." Based on this, the district court ruled that Salsbury's messianic beliefs were not probative of bias and therefore were inadmissible under Fed. R. Evid. 610. This conclusion was not only proper, it was in fact compelled by Fed. R. Evid. 610. *See, e.g., United States v. Sampol*, 636 F.2d 621, 666 (D.C. Cir. 1980). Accordingly, we do not find the district court's ruling to have been an abuse of discretion. Moreover, we note that in light of the extensive cross-examination of Salsbury which extended over five days and exhaustively covered many bases for impeachment, any additional inferences to be elicited

from Salsbury's religious beliefs would have been of only marginal value at best.

II. *The Jury Charge*

Teicher and Frankel contend that the district court's jury charge erroneously instructed the jury that the defendants could be found guilty of securities fraud based upon the mere possession of fraudulently obtained material nonpublic information without regard to whether this information was the actual cause of the sale or purchase of securities. Specifically, Teicher and Frankel argue that the charge permitted the jury to find them guilty of securities fraud even if they had traded upon only publicly available information. We find this argument unpersuasive.

Under the misappropriation theory of securities fraud as adopted by this Circuit, "a person violates Rule 10b-5 when he misappropriates material nonpublic information in breach of a fiduciary duty or similar relationship of trust and confidence and uses that information in a securities transaction." *United States v. Chestman*, 947 F.2d 551, 566 (2d Cir. 1991) (in banc), *cert. denied*, 112 S. Ct. 1759 (1992); *see also United States v. Carpenter*, 791 F.2d 1024, 1028-29 (2d Cir. 1986), *aff'd by equally divided court*, 484 U.S. 19 (1987); *SEC v. Materia*, 745 F.2d 197, 201-02 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985). In accordance with the misappropriation theory, the district court instructed the jury:

> The government charges that [the defendants] knowing that information to have been misappropriated, received and exploited that information by using it for their own advantage.

In defining misappropriation, the district court charged:

> To misappropriate, in the context of this case, means to wrongfully take and use the information in violation of a fiduciary duty to hold the information in confidence.

Teicher and Frankel do not contest the propriety of these and similar portions of the charge. Rather, they focus on the part of the charge in which the court instructed:

> The government need not prove a causal relationship between the misappropriated material nonpublic information and the defendants' trading. That is, the government need not prove that the defendants purchased or sold securities because of the material nonpublic information that they knowingly possessed. It is sufficient if the government proves that the defendants purchased or sold securities while knowingly in possession of the material nonpublic information.

Placing great emphasis upon the term "use," they contend that the district court too broadly defined this word as the equivalent of mere possession. They posit the alternative theory that a defendant only "uses material nonpublic information where it can be proven that the trading was *causally connected* to the misappropriated information and hence, was proven *not* to have been conducted on an independent and proper basis." A causal connection standard would find no violation where a trader executes a previously and legitimately planned transaction after the trader wrongfully receives material nonpublic information which confirmed the transaction.

Although this argument is a novel one, the question of whether a violation of Rule 10b-5 requires an

actual causal connection between the misappropriated information and the trading has been raised by commentators. *See, e.g.*, 3 A. Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud*, § 7.4 (622), p. 7:160.15 (1992). In support of their position that a causal connection is an element of the violation, Teicher and Frankel rely largely on cases which describe securities charges with phrases such as "trading on the basis of" but which did not address the possibility that the trading was *not* causally connected to the inside information. *See, e.g., Dirks v. SEC*, 463 U.S. 646, 648 (1983); *SEC v. Materia*, 745 F.2d at 199-200 (2d Cir. 1984).

In contrast, the government advances the view, which has been consistently endorsed by the SEC, that a violation of § 10(b) and Rule 10b-5 occurs when a trade is conducted in "knowing possession" of material nonpublic information obtained in breach of a fiduciary or similar duty. *See, e.g., Sterling Drug Inc. Investigation*, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 81,570, p. 80,298 ("The Commission also believes that Rule 10b-5 does not require a showing that an insider sold his securities for the purpose of taking advantage of material nonpublic information. . . . If an insider sells his securities while in possession of material adverse nonpublic information, such an insider is taking advantage of his position to the detriment of the public." (citation omitted)) Rule 14e-3, which prohibits fraud in connection with tender offers explicitly provides a "knowing possession" standard. As the promulgator of Rule 10b-5, the SEC's interpretation that this rule only requires "knowing possession" is entitled to some consideration. *See, e.g., TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 n. 10 (1976).

A number of factors weigh in favor of a "knowing possession" standard. First, as the government points out, both § 10(b) and Rule 10b-5 require only that a deceptive practice be conducted "in connection with the purchase or sale of a security." We have previously stated that the "in connection with" clause must be "construed . . . flexibly to include deceptive practices 'touching' the sale of securities, a relationship which has been described as 'very tenuous indeed.'" *United States v. Newman*, 664 F.2d 12, 18 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983) (citing *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971) (citation omitted)). Thus, for example, "the predicate act of fraud may be perpetrated on the source of the nonpublic information, even though the source may be unaffiliated with the buyer or seller of securities." *Chestman*, 947 F.2d at 566 (citing *Carpenter*, 791 F.2d at 1032).

In addition, a "knowing possession" standard comports with the oft-quoted maxim that one with a fiduciary or similar duty to hold material nonpublic information in confidence must either "disclose or abstain" with regard to trading. *See Chiarella v. United States*, 445 U.S. 222, 227 (1979). When the fiduciary is an insider who is not in a position to make a public announcement, the fiduciary must abstain. It would be consistent with the "disclose or abstain" rule that a tippee acquire the same duty as his fiduciary tipper.

Finally, a "knowing possession" standard has the attribute of simplicity. It recognizes that one who trades while knowingly possessing material inside information has an informational advantage over other traders. Because the advantage is in the form

of information, it exists in the mind of the trader. Unlike a loaded weapon which may stand ready but unused, material information can not lay idle in the human brain. The individual with such information may decide to trade upon that information, to alter a previously decided-upon transaction, to continue with a previously planned transaction even though publicly available information would now suggest otherwise, or simply to do nothing. In our increasingly sophisticated securities markets, where subtle shifts in strategy can produce dramatic results, it would be a mistake to think of such decisions as merely binary choices—to buy or to sell.

As a matter of policy then, a requirement of a causal connection between the information and the trade could frustrate attempts to distinguish between legitimate trades and those conducted in connection with inside information. *See* 7 L. Loss & J. Seligman, *Securities Regulation* 3505 (3d ed. 1991) ("The very difficulty of establishing actual use of inside information points to possession as the test.").

In any event, we need only rule with respect to the case before us. Viewing the jury charge in its entirety and based upon the record, we find that it is unnecessary to determine whether proof of securities fraud requires a causal connection, because any alleged defect in the instruction was harmless beyond doubt.

This case involves the fast-paced and perilous world of arbitrage. Arbitrageurs are in the business of gathering information. As described by Teicher, arbitrageurs "combin[e] publicly available information with rumors and other tidbits of immaterial nonpublic information in formulating investment strategies." By their own admission, Teicher and Frankel

actively sought and received such "tidbits" in order to weave them into a material whole upon which they traded. It does not follow, that when one such piece of information is revealed to be material, in and of itself, and the trader knows it to be material, the trader might somehow consider the information irrelevant to the whole.

In fact, the question of what Teicher and Frankel believed about the tipped information was properly placed before the jury. Contrary to their assertions, the district court's charge did not preclude Teicher and Frankel from arguing, as they did, that they "never knowingly sought, obtained, or traded upon material nonpublic information from either David or Salsbury." Properly construed, Teicher and Frankel's defense theory was not that they did not *rely* on the material information they knowingly possessed. Rather, they argued that they either did not *know* the information was material and nonpublic or did not *know* the information to be wrongfully acquired. In other words, Teicher and Frankel's defense centered on the strategy that they lacked the requisite scienter to have committed securities fraud.

With regard to scienter, the district court charged:

> It is not a willful deceptive device in contravention of Rule 10b-5 for a person to use his superior financial or expert analysis or his educated guesses or predictions or his past practices or experience to determine what stocks to purchase or to sell. Nor is it a deceptive device in contravention of Rule 10b-5 for a person to buy or sell stocks based on rumors, gossip, stories, or any other source consisting of unverified, unsubstantiated information.

> Each of the defendants argues that he or it acted at all times in good faith, It is up to you to decide whether that is the case or not. If you decide that the defendant you are considering at all relevant times acted in good faith, it is your duty to acquit him or it, not only on the conspiracy count, but on all counts.

It strains reason to argue that an arbitrageur, who traded while possessing information he knew to be fraudulently obtained, knew to be material, knew to be nonpublic,—and who did not act in good faith in so doing—did not also trade on the basis of that information. We find that on the facts of this case, no reasonable jury could have made such a distinction. *See Yates v. Evatt*, 111 S. Ct. 1884, 1892-93 (1991); *United States v. Collins*, 957 F.2d 72, 75 (2d Cir.), *cert. denied*, 112 S. Ct. 2285 (1992).

We have reviewed each of the appellants' remaining contentions and find them to be without merit.

CONCLUSION

Based on the foregoing, the judgment of the district court is affirmed.

APPENDIX B

UNITED STATES DISTRICT COURT
S.D. NEW YORK

No. 88 Cr. 796 (CSH)

UNITED STATES OF AMERICA

v.

VICTOR TEICHER & CO., L.P.,
VICTOR TEICHER AND ROSS S. FRANKEL,
DEFENDANTS

Feb. 25, 1992

Roger S. Hayes, Acting U.S. Atty., S.D.N.Y. (John W. Auchincloss II, Asst. U.S. Atty., of counsel), New York City, for U.S.

Morvillo, Abramowitz & Grand, P.C. (Robert G. Morvillo, Robert J. Anello, Catherine M. Foti, of counsel), New York City, for defendants Victor Teicher & Co., L.P. and Victor Teicher.

Bernstein & Milner (Michael M. Milner, Roger J. Bernstein, of counsel), New York City, for defendant Ross S. Frankel.

MEMORANDUM OPINION AND ORDER

HAIGHT, District Judge:

This case is before the Court on defendants' post-trial motions for judgments of acquittal pursuant to Fed.R.Crim.P. 29(c), or, alternatively, for a new trial pursuant to Fed.R.Crim.P. 33.

On November 11, 1988 the defendants, as well as D. Ronald Yagoda and Marcus Schloss & Co. Inc., were charged in a 31—count indictment charging, *inter alia*, conspiracy, securities fraud, mail fraud and perjury. Yagoda and Marcus Schloss were severed out and tried separately in May 1989. *See United States v. Marcus Schloss & Co., Inc.*, 710 F.Supp. 944, 945 (S.D.N.Y.1989). The indictment was redacted to eliminate these defendants.

Defendants were tried before this Court and a jury from January 19, 1990 through April 6, 1990.

Defendants first made Rule 29 motions for dismissal of all counts at the close of the government's case and Counts 13, 14, 15, 16 and 19 were dismissed although the other counts were allowed to stand. *See United States v. Victor Teicher & Co., L.P., et al.*, 88 Crim. 796 (CSH), Memorandum Opinion and Order, 1990 WL 29697 (S.D.N.Y. March 9, 1990) ("3/9/90 slip op."). The indictment given to the jury in this case was further redacted to reflect the dismissals of these counts.

Count 1 of the indictment charged that from July 1, 1985 to on or about April 30, 1986 defendants Victor Teicher & Co., L.P., Victor Teicher ("the Teicher defendants") and Ross S. Frankel conspired, in violation of 18 U.S.C. § 371, to commit securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff and 17

C.F.R. § 240.10b-5; fraud in connection with a tender offer in violation of 15 U.S.C. §§ 78n(e) and 78ff and 17 C.F.R. § 240.14e-3(a); and mail fraud in violation of 18 U.S.C. § 1341. Counts 2 through 10 charged the Teicher defendants with securities fraud with respect to certain securities in violation of 15 U.S.C. §§ 78j(b) and 78ff, 17 C.F.R. § 240.10b-5 and 18 U.S.C. § 2. Count 8 charged defendant Frankel with securities fraud with respect to one of those securities, American Brands, Inc. Counts 11 and 12 charged the Teicher defendants with fraud with respect to the tender offer by Dominion Textile Company, Ltd. for Avondale Mills in violation of 15 U.S.C. §§ 78n(e) and 78ff, 17 C.F.R. § 240.14e-3(a) and 18 U.S.C. § 2. Counts 13 and 14 charged Victor Teicher with mail fraud in violation of 18 U.S.C. §§ 1341 and 2. Count 15 charged Frankel with mail fraud in violation of 18 U.S.C. § 1341. Count 16 charged Frankel with four specifications of perjury before the Securities and Exchange Commission ("S.E.C.") in violation of 18 U.S.C. § 1621. Counts 17 and 18 charged Frankel with obstruction of justice in violation of 18 U.S.C. §§ 1505 and 2.

On March 23, 1990, at the conclusion of all the evidence in the case, defendants again moved for judgments, of acquittal under Rule 29. The Court reserved decision on the defendants' motions. Transcript of Trial January 19, 1990—April 6, 1990 ("Tr.") at 6730.

On April 6, 1990 the jury returned verdicts of guilty against Victor Teicher & Co., L.P. and Victor Teicher on Counts 1-12, against Victor Teicher on Counts 13 and 14 and verdicts of guilty against Frankel on Counts 1, 8 and 15-18.

On May 2, 1990 the United States Court of Appeals for the Second Circuit issued its decision in *United States v. Chestman*, 903 F.2d 75 (1990), *rev'd in part and aff'd in part*, 947 F.2d 551 (2d Cir. 1991), *petitions for cert. filed* (U.S. Jan. 1 and 2, 1992) ("*Chestman I*"), reversing Rule 10b-5, Rule 14e-3, mail fraud and perjury convictions obtained after a jury charge substantially similar to the charge in the case at bar. On May 14 and 21, 1990 the Teicher defendants and Frankel, respectively, filed post-trial motions for judgments of acquittal under Rule 29 or, in the alternative, for a new trial under Rule 33.

On August 24, 1990 the Second Circuit granted rehearing *en banc* of *Chestman I* and this Court deferred decision on the pending post-trial motions until the Second Circuit's *en banc* ruling.

On October 7, 1991 the Second Circuit issued its *en banc* decision. *United States v. Chestman*, 947 F.2d 551 (2d Cir.1991), *petitions for cert. filed* (U.S. Jan. 1 and 2, 1992) ("*Chestman II*"). *Chestman II* reversed in part and affirmed in part the panel's decision. Based on the *en banc* decision in *Chestman II* the defendants have filed briefs and letter-briefs supplementing the post-trial motions. Defendants' motions are now fully briefed and ripe for decision.

For the reasons set forth below, defendants' motions are denied.

BACKGROUND

To the extent that defendants challenge the sufficiency of the evidence against them, the standard of review is clear.

The evidence at trial, viewed in the light most favorable to the government, *see United States v.*

Simmons, 923 F.2d 934, 953 (2d Cir.), *cert. denied*, —— U.S. ——, 112 S.Ct. 383, 116 L.Ed.2d 334 (1991), established the facts as follows:

Defendant Teicher was the principal of defendant Victor Teicher & Co., L.P., a securities firm. The evidence showed that Teicher received confidential information concerning the securities of publicly traded companies from co-conspirators Michael David of the law firm of Paul Weiss Rifkind Wharton & Garrison and Robert Salsbury of the investment firm Drexel Burnham Lambert.

The evidence showed that Teicher received confidential information about the names of companies on the Drexel "phantom list." This list contained the names of companies that Drexel was not to trade in because the firm was working on transactions involving them. Tr. 4728-29. Salsbury testified that Teicher repeatedly asked him for the identity of companies on the list. Salsbury initially resisted giving Teicher the names on the list, and when he did reveal the names he told Teicher that he should not disclose the information to any ~~other~~ person. Tr. 2253, 3018, 3031-33.

The evidence showed that while working at Salomon Brothers in the late 1970s, Teicher became familiar with what Salomon Brothers called a "restricted list." This list contained a list of stocks in which Salomon Brothers was not permitted to trade.[1] Tr. 6287-6293.

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[1] Although in his own testimony Teicher maintained that he had never even heard of the Drexel phantom list in the period between October 1985 through March 1986, I disregard that denial for the purpose of this analysis.

In late February and March 1986, Teicher purchased stocks in companies within a day or on the day that the company was placed on the Drexel phantom list. On March 14, 1986 Teicher purchased $710,000 worth of Warnaco stock on the day after Warnaco was added to the Drexel phantom list. The government also proved that Teicher had traded in other Drexel phantom list stocks, namely Republic Airlines (Count 2) and Westchester Financial Services Corporation (Count 3). GX 81 B.

The evidence also showed that Teicher received material nonpublic information that Michael David had misappropriated from Paul Weiss and its client Triangle Industries. During his direct testimony David stated:

> I said [to Teicher that] I had learned within Paul Weiss that American Can at sometime in the future may become a takeover target by a Paul Weiss client, Triangle Industries, but that was uncertain at that time. . . . I said, if it would happen at all it would happen within six months.
>
> Tr. 287-88.

On redirect examination David testified that:

> While I conveyed to him that it came from Paul Weiss, I did not mention the actual source of my information. That's Mr. Lee Pershan, the actual lawyer I talked to or I learned it from. . . . I not only told him that Triangle Industries would take over American Can at sometime in the future, depending on certain antitrust barriers, but I also conveyed to him in words which

I don't recollect that that information came from Paul Weiss.

Tr. 767-68.

The evidence showed that on March 11, 1986 Michael David told Teicher, in a conversation which took place in Teicher's office, that Paul Weiss was working on a deal involving Revco. Up to this point David had tipped Teicher on four previous Paul Weiss deals, with a tip on American Brands having been given the day before.

David testified that on the morning of March 11, 1986 he "told [Teicher] that the price of the buyout was supposed to go to thirty-five and only thirty-five and that the stock was trading a little bit too close to $35 a share." David testified that he told Teicher that he had gotten that information either from Andrew Solomon, another co-conspirator, or from Marcus Schloss & Co. Tr. 419, 778. The evidence showed that Teicher acted on the tip that same morning. On March 11, 1986 the opening of Revco trading was delayed because of the announcement of the pending buy-out offer that appeared on the broad tape at 9:57 a.m. Solomon testified that when Solomon's boss Yagoda saw that announcement he told Solomon to tell David to sell Revco stock short because the market price was too high relative to what Yagoda knew about the actual price of the buy-out. Solomon relayed that information to David, who in turn tipped Teicher, who sold 5,000 shares short by 10:21 a.m. Tr. 414, 421, 778, 1214-16.[2]

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[2] Teicher's testimony, which does not have to be credited when viewing the evidence in the light most favorable to the government, did little to alleviate the clear implication that

The evidence showed that Ross S. Frankel was a corporate vice president at Drexel Burnham Lambert *doing research analysis* in the domestic arbitrage department. In August 1985 Salsbury was hired to do financial analysis in the department. Ronald Geffen was also part of the research analysis team in the domestic arbitrage department. Tr. 4720-4752.

The evidence showed that Salsbury tipped Frankel about American Brands and told Frankel that the information came from Michael David, whose law firm was representing a company, BAT Industries, that was considering a takeover of American Brands. In the days leading up to March 10, 1986 Salsbury had three conversations with Michael David concerning American Brands and Salsbury related each conversation to Frankel. After the first conversation, Salsbury testified that he told Frankel "that Michael's firm is representing a British client in the acquisition of American Brands." Frankel replied by saying "that it was good information, try to get more, and tell Michael to be careful." After the second conversation with David, Salsbury testified that he told Frankel that "Paul Weiss had gone forward and gotten SEC documents . . . on American Brands." After

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he had traded on inside information. According to Teicher, he was familiar with Revco because he had taken a "fly" on it in September 1984 and then he had "taken a look at" Revco again in the summer of 1985. Teicher testified that on the morning of March 11, David told Teicher that Solomon valued Revco at $35.00 per share. When Teicher said that the felt the stock was worth only $31 to $33 per share, David said, "well, if that's the way you feel, why don't you short some shares?" Teicher testified that he took a look at Revco's price-volume history and sold short 5,000 shares for $168,000. Tr. 6269-72.

the third conversation with David, Salsbury testified that he told Frankel "all the information about who the client was . . . I told him in fact that BAT U.S. was the acquirer. . . . that it was—he knew it came from Paul, we discussed it coming from Paul Weiss." Tr. 2304-06. The evidence showed that Frankel was a lawyer, who had once worked at the firm of Morgan Lewis & Bockius, and was aware of the fiduciary duties lawyers owe to clients. Tr. 4715-17.

On March 10, 1986, after Salsbury relayed his third conversation with David, Frankel purchased ten American Brands call options. Frankel also allowed Salsbury to buy two options in Frankel's account at Drexel Burnham Lambert.

The government also proved a number of incidents from which it was entitled to an inference of knowledge on Frankel's part of the source of inside information. Michael David testified that when Frankel saw David at Teicher's office on March 10, 1986 Frankel warned David to "be a little bit more low key." Tr. 410. Frankel admitted, albeit with a different explanation, that he told David "I don't think you should be playing arb on Paul Weiss's time." Tr. 4888. Frankel testified that he told Salsbury on March 11, 1986 that he had seen David at Teicher's office and that Frankel "thought it was a little strange and not too good an idea." Tr. 5159. Salsbury's version of the conversation is that Frankel "was very upset and told Salsbury that he "should tell Victor he shouldn't do that any more." Tr. 2314. Sometime later in March 1986 while Salsbury and David spoke on the phone, Frankel told Salsbury to ask David "if it [American Brands] still was on and when it would occur." Tr. 2336.

The evidence showed and the government was entitled to the inference that once an investigation by the S.E.C. began, Frankel attempted a cover-up. Salsbury testified, and was corroborated by Geffen, that Frankel retrieved a check that was Salsbury's payment for his second set of American Brands call options purchased in Frankel's account and that Frankel destroyed the margin slip that accompanied the check. Tr. 2374-76; 4282-85. Salsbury testified that Frankel created a list of lawful reasons for purchasing the American Brands call options and rehearsed Salsbury on those reasons. Tr. 2372-73. Salsbury and Geffen testified that Frankel had instructed Geffen to destroy a page from Frankel's desk calendar that showed the payment by Salsbury. Tr. 2385, 4313. Those same two witnesses testified that Frankel only told in house counsel about the first—but not the second—set of American Brands options purchased by Salsbury and instructed Salsbury to do the same. Tr. 2380-84, 4289-90.

The evidence showed that Frankel gave contradicting statements on whether Salsbury had done research on American Brands in February of 1986 and the government was entitled to the inference that Frankel had committed perjury. *See* Indictment, Count 16, Specifications 1, 2 and 4. During his appearance before the S.E.C. Frankel testified that Salsbury had done research in February 1986 at Frankel's request and that Frankel had not asked Salsbury to do any research on March 10, 1986. In contrast, Salsbury testified that he did no research in February and that the first time Frankel had asked him to do research was after Frankel and Salsbury had purchased American Brands call options on March 10, 1986.

Tr. 2318-20. On June 3, 1986 Frankel initially told the S.E.C. that "the Salsbury analysis was before March 10" and that Salsbury "had already done the financial analysis on my request a while before [March 10]." The S.E.C. then confronted Frankel with a memorandum he had written to Drexel's in house counsel Paul Merolla on April 29, 1986. That memorandum, which Frankel had written, stated that "on March 10, 1986, I told Bob that I was considering buying some American Brands calls and asked him to do a brief financial analysis of the underlying common stock." The memorandum mentioned nothing about research being done before March 10, 1986. Tr. 5036-38. When Frankel saw this memorandum at the S.E.C. he stated that it was wrong and said "I don't know why I wrote that." GX 6 at 124.

On June 5, 1986 Frankel gave another version to the S.E.C. and also relied on this version at the trial before this Court. In this version Frankel stated that he had asked Salsbury to do an analysis in February and had only asked him to do an "update" on March 10 to compare American Brand to other tobacco stocks. Tr. 4973, 5048. But the research in Salsbury's notebook on the back of a page dated March 12, 1986 is an analysis of the break-up value of American Brands using 1984 numbers. It makes no mention of any other tobacco companies. Tr. 5048.

On March 23, 1990 the Teicher defendants moved for judgments of acquittal at the conclusion of all of the evidence and argued that the government's evidence was insufficient to convict and that the alleged inside information was immaterial. Memorandum of Law In Support of Teichers' Defendants Motion

("Teicher Trial Mem.") at 1-4.[3] The Court reserved decision on these motions.

In May 1990, following the verdicts of guilty, the Teicher defendants renewed their March 23, 1990 motions for judgments of acquittal on all counts of the indictment. The Teicher defendanats also moved for judgments of acquittal as to each count of the indictment based on the Second Circuit's decision in *Chestman I*. The Teicher defendants also moved for judgments of acquittal as to all counts of the indictment on the ground that, when viewed in light of all of the evidence at trial, the testimony of the government's two main witnesses, Michael David and Robert Salsbury was so contradictory and inconsistent on its face that the Court should find their testimony incredible as a matter of law. The Teicher defendants argued that the Rule 14e-3 convictions should be vacated because Rule 14e-3 had been held invalid in *Chestman I*.

In the alternative, the Teicher defendants requested that the Court grant them a new trial. The Teicher defendants argued that even if the Court found that the evidence was technically sufficient, the nature of the proof was such that the verdict reached was contrary to the weight of the evidence and should be set aside and a new trial granted under Fed.R.Crim.P. 33. Memorandum of Law in Support of Victor Teicher and Victor Teicher & Co.'s Motion For a Judgment of Acquittal or, Alternatively, For a New Trial ("Teicher Post-Trial Mem.") at 2-3.

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[3] Defendant Frankel joined this motion to the extent it related to American Brands. *See* Teicher Trial Mem. at 4 n. 3.

After *Chestman II* the Teicher defendants press their 14e-3, sufficiency and materiality arguments. *See* Letter Of Robert J. Anello, Esq. dated December 6, 1991 ("Teicher Supp. Letter").

Defendant Frankel filed a post-trial motion arguing that Frankel was entitled to judgments of acquittal under Fed. R.Crim.P. 29 because of the Second Circuit's decision in *Chestman I*. In the alternative, Frankel asked for a new trial under Fed.R.Crim.P. 33, contending that the verdicts were contrary to the weight of the evidence. Memorandum of Iaw In Support of Ross Frankel's Motion ("Frankel Post-Trial Mem.") at 2.

Relying on *Chestman II* Frankel argues that there was never a duty of confidentiality proven between Salsbury and David, and accordingly the jury could not have found that such a duty extended to Frankel. Frankel argues that the government never proved that he knew the information was confidential and that, even if he had, knowledge alone is not enough for a conviction under Rule 10b-5. Defendant Frankel's Supplemental Memorandum ("Frankel Supp. Mem.") at 5-7.

After *Chestman I* the government responded that the decision had not changed the elements of Rule 10b-5 liability and that those elements had been proved in this case. The government contended that the evidence was sufficient to convict Frankel of mail fraud, conspiracy and perjury. The government suggested that the defendants be sentenced on the Rule 14e-3 convictions which could then be dismissed if the panel's decision was allowed to stand. Government's Memorandum of Law In Opposition ("Gov. Mem.") at 10-37.

Relying on *Chestman II* the government now argues that it was not required to show that each member of a line of tippees accepted a duty of confidentiality. The government contends that the critical requirement is knowledge that information is confidential and that that element was proved in this case. The government continues to argue that since the mail fraud convictions are related to the securities fraud convictions, which must be sustained, the mail fraud convictions should be upheld. The government notes that *Chestman II* has ended any questions about the validity of Rule 14e-3 and urges that the 14e-3 convictions be upheld. Government's Supplemental Memorandum In Opposition ("Gov.Supp.Mem.") at 2-14.

DISCUSSION

The standards for reviewing post-conviction motions are well-settled. A defendant challenging the sufficiency of the evidence carries a "very heavy burden." *United States v. Alkins*, 925 F.2d 541, 555 (2d Cir.1991) (citations omitted). A reviewing court "must construe the evidence in the light most favorable to the government and draw all inferences in its favor." *United States v. Teitler*, 802 F.2d 606, 615 (2d Cir.1986) (citations omitted). "[A] jury's verdict will be sustained if there is substantial evidence, taking the view most favorable to the government, to support it." *United States v. Scarpa*, 913 F.2d 993, 1004 (2d Cir.1990) (citation omitted). The government is not "required to preclude every reasonable hypothesis which is consistent with innocence." *United States v. Chang An-Lo*, 851 F.2d 547, 554 (2d Cir.) (citation omitted), *cert. denied*, 488 U.S. 966, 109 S.Ct. 493, 102 L.Ed.2d 530 (1988). "If

'*any* rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt,' the conviction must be upheld." *United States v. Nersesian*, 824 F.2d 1294, 1324 (2d Cir.) (citing and quoting *Jackson v. Virginia*, 443 U.S. 307, 99 S.Ct. 2781, 61 L.Ed.2d 560 (1979)) (emphasis in original), *cert. denied*, 484 U.S. 958, 108 S.Ct. 357, 98 L.Ed.2d 382 (1987).

"The fact that a conviction may be supported only by the uncorroborated testimony of a single accomplice is not a basis for reversal if that testimony is not incredible on its face and is capable of establishing guilt beyond a reasonable doubt." *United States v. Parker*, 903 F.2d 91, 97 (2d Cir.), *cert. denied*, —— U.S. ——, 111 S.Ct. 196, 112 L.Ed.2d 158 (1990). "The evidence is to be viewed 'not in isolation but in conjunction.' " *United States v. Mariani*, 725 F.2d 862, 865 (2d Cir.1984) (citation omitted).

I. Securities Convictions

A. *The Rule 10b-5 Convictions*

At the conclusion of the evidence the Teicher defendants moved under Fed.R.Crim.P. 29 for judgments of acquittal on Counts 2, 4, 5, 7, 8, 9, 12, 13, 14. This motion focused on the standard for "materiality" of nonpublic information set forth in this Court's March 9, 1990 opinion denying the Rule 29 motions at the close of the government's case. The Court relied on the Supreme Court's holding in *T.S.C. Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976). *See* 3/9/90 slip op. at 2-4. The Teicher defendants argued that the jury could not find beyond a reasonable

doubt that they had been in possession of material information regarding American Can, Allegheny International, American Brands or Revco or regarding Avondale Mills after February 26, 1986. The Teicher defendants contended that the government had failed to show Teicher's knowledge of any harm from his claimed improper conduct with regard to Revco and Republic. In addition, the Teicher defendants contended that the government had failed to establish that trading in Avondale was directed by Teicher. Teicher Trial Mem. 3-23.

In their post-trial motion the Teicher defendants, relying on *Chestman I*, argued that the government's evidence was insufficient to support convictions under Rule 10b-5. The Teicher defendants maintained that there was insufficient evidence to prove that they knew the information concerning Revco, the companies on the phantom list (Republic, Westchester and Warnaco) and American Can was confidential. In addition, the Teicher defendants contended that the information concerning American Can, Allegheny, American Brands and Revco could not be material because it was inaccurate. The Teicher defendants argued that the government presented insufficient proof of a single conspiracy. The Teicher defendants contended that the government's proof was insufficient to demonstrate that Teicher ordered trading in Avondale Mills. The Teicher defendants argued that the mail fraud convictions had to be overturned because the information was inaccurate and so could not be property. Teicher Post-Trial Mem. at 5-25.

The Teicher defendants argue that under *Chestman II* the evidence at trial was insufficient to prove that Teicher knew the information as to Revco, the

companies on the phantom list and American Can was confidential and so was guilty of a violation of Rule 10(b)-5. In addition, the Teicher defendants maintain that there is no fiduciary duty with regard to false, stale or inaccurate information. *See* Teicher Supp. Letter. at 3.

Frankel's post-trial motion challenged the convictions under Counts 8 and 15 for securities and mail fraud related to trading in American Brands, Inc. Relying on *Chestman I*, Frankel argued that the government had presented insufficient evidence that Salsbury accepted a duty of confidentiality on Paul, Weiss information from David and that Frankel knew that Salsbury was breaching any duty when he provided information to Frankel about the possible acquisition of American Brands. In addition, Frankel argued that there was no evidence that Frankel was ever advised by anyone that the Paul Weiss information from Salsbury was confidential and had been divulged in violation of a fiduciary duty. Frankel Post-Trial Mem. at 8.

After *Chestman II* Frankel presses the argument that his Rule 10b-5 conviction on Count 8 must be vacated. Frankel argues that since there was no fiduciary relationship between Salsbury and David and no express acceptance of a duty of confidentiality by David, the government had to show an implied acceptance of duty by Salsbury. Frankel argues that no such evidence was offered. Frankel contends there was no evidence David told Salsbury that the information was confidential and no evidence that Frankel ever knew Salsbury was breaching a duty of confidentiality, even if there was such a duty. Frankel argues that the government never proved he knew

the information was confidential and that even if the government had proved such knowledge, knowledge alone is insufficient to sustain 10b-5 liability. Frankel Supp.Mem. 4-7.

The government argues that *Chestman II* reaffirmed the existing standard for Rule 10b-5 liability that was used in this trial. The government contends that it must prove that the misappropriator violated a fiduciary or similar duty and that the tippee knew of the breach. The government argues that there was ample evidence that Teicher knew the information on Revco, the Drexel phantom list and American Can was confidential. The government rejects defendants' contention that some of the information was not material. As to Revco and American Can, the government points to David's testimony that he told Teicher the information was confidential. Regarding the Drexel phantom list the government points to Salsbury's reluctance to reveal the contents of the list and Teicher's knowledge about such lists. Gov. Supp.Mem. at 9-11.

The government argues that the evidence showed that Michael David misappropriated the American Brands information from Paul Weiss and that Salsbury was the intermediary to Frankel. The government rejects Frankel's contention that the government must show that David breached a duty to his firm *and* that Salsbury owed and breached a duty to David *and* that Frankel knew of both duties and breaches. The government contends that it was required to show that David breached a duty and that Frankel knew of that breach. As to David's duty the government argues that his duty was axiomatic as an attorney at Paul Weiss. The government points to Salsbury's testimony, Frankel's previous experi-

ence as an attorney, David's testimony and Frankel's cover up attempts as sufficient evidence that Frankel knew David had breached a duty. Gov.Supp.Mem. at 11-13.

1. The Standard for Rule 10b-5 Liability

In *Chestman II* the Second Circuit reviewed the standard for criminal liability under Rule 10b-5.[4] The Second Circuit stated the facts of *Chestman II* as follows:

> Robert Chestman is a stockbroker. Keith Loeb first sought Chestman's services in 1982, when Loeb decided to consolidate his and his wife's holdings in Waldbaum, Inc. (Waldbaum), a publicly traded company that owned a large super-

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[4] 15 U.S.C. 78j (b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or any facility of any national securities exchange. . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

17 C.F.R. § 240.10b-5 provides in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme or artifice to defraud, . . . or (c) to engage in any act practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

market chain. During their initial meeting, Loeb told Chestman that his wife was a granddaughter of Julia Waldbaum, a member of the board of directors of Waldbaum and the wife of its founder. Julia Waldbaum also was the mother of Ira Waldbaum, the president and controlling shareholder of Waldbaum. From 1982 to 1986 Chestman executed several transactions involving Waldbaum restricted and common stock for Keith Loeb. To facilitate some of these trades, Loeb sent Chestman a copy of his wife's birth certificate which indicated that his wife's mother was Shirley Waldbaum Witkin.

On November 21, 1986, Ira Waldbaum agreed to sell Waldbaum to the Grant Atlantic and Pacific Tea Company (A & P). The resulting stock purchase agreement required Ira to tender a controlling block of Waldbaum shares to A & P at a price of $50 per share. Ira told three of his children, all employees of Waldbaum, about the pending sale two days later, admonishing them to keep the news quiet until a public announcement. He also told his sister Shirley Witkin, and nephew, Robert Karin, about the sale, and offered to tender their shares along with his controlling block of shares to enable them to avoid the administrative difficulty of tendering after the public announcement. He cautioned them "that [the sale was] not to be discussed," that it was to remain confidential.

In spite of Ira's counsel, Shirley told her daughter, Susan Loeb, on November 24 that Ira was selling the company. Shirley warned Susan not to tell anyone except her husband, Keith Loeb, because disclosure could ruin the sale. The next

day, Susan told her husband about the pending tender offer and cautioned him not to tell anyone because "it could possibly ruin the sale."

The following day, November 26, Keith Loeb telephoned Robert Chestman at 8:59 a.m. Unable to reach Chestman, Loeb left a message asking Chestman to call him "ASAP." According to Loeb, he later spoke with Chestman between 9:00 a.m. and 10:30 a.m. that morning and told Chestman that he had "some definite, some accurate information" that Waldbaum was about to be sold at a "substantially higher" price than its market value. Loeb asked Chestman several times that he thought Loeb should do. Chestman responded that he could not advise Loeb that to do "in a situation like this" and that Loeb would have to make up his own mind.

That morning Chestman executed several purchases of Waldbaum stock. At 9:49 a.m., he brought 3,000 shares for his own account at $24.65 per share. Between 11:31 a.m. and 12:35 p.m., he purchased an additional 8,000 shares for his clients' discretionary accounts at prices ranging from $25.75 to $26.00 per share. One of the discretionary accounts was the Loeb account, for which Chestman brought 1,000 shares.

Before the market closed at 4:00 p.m., Loeb claims that he telephoned Chestman a second time. During their conversation Loeb again pressed Chestman for advice. Chestman repeated that he could not advise Loeb "in a situation like this," but then said that, based on his research, Waldbaum was a "buy." Loeb subsequently ordered 1,000 shares of Waldbaum stock.

> Chestman presented a different version of the day's events. Before the SEC and at trial, he claimed that he had purchased Waldbaum stock based on his own research. He stated that his purchases were consistent with previous purchases of Waldbaum stock and other retail food stocks and were supported by reports in trade publications as well as the unusually high trading volume of the stock on November 25. He denied having spoken to Loeb about Waldbaum stock on the day of the trade.

Chestman II, 947 F.2d at 555.

Based on these facts Chestman was convicted of ten counts of fraudulent trading in connection with a tender offer is violation of Rule 14e-3, ten counts of securities fraud in violation of Rule 10b-5, ten counts of mail fraud and one count of perjury for his testimony before the S.E.C. Chestman was convicted under the "misappropriation theory" which provides that "one who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates 10(b) and Rule 10b-5." *SEC v. Materia*, 745 F.2d 197, 203 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053, 105 S.Ct. 2112, 85 L.Ed.2d 477 (1985). As to shares Chestman purchased for Loeb, Chestman was convicted of aiding and abetting Loeb's misappropriation of nonpublic information in breach of Loeb's duty to the Waldbaums and his wife Susan. For shares Chestman purchased for himself and clients Chestman was convicted as a "tippee" of the same misappropriated information. *Chestman II*, 947 F.2d at 564.

The panel in *Chestman I* reversed all of Chestman's convictions. On the Rule 10b-5 convictions the panel held that there was no evidence that Chestman knew that the information was confidential. The panel stated that there was no evidence that Chestman knew "that Keith Loeb was pledged to secrecy by Susan Loeb, who was pledged to secrecy by Shirley Witkin, who was pledged to secrecy by Ira Waldbaum." *Chestman I*, 903 F.2d at 79. Since Chestman did not know that the information was confidential, the panel reversed the mail fraud convictions. As to the perjury conviction the panel held that the government's proof did not overcome the "two-witness" rule required for perjury convictions. *Id.* at 79-82. While two of the three judges on the panel rejected Chestman's contention that Rule 14e-3 was an invalid exercise of the S.E.C.'s rulemaking authority, the Rule 14e-3 conviction was also reversed. Judge Mahoney found that Rule 14e-3 was invalid and Judge Carman [5] found that the trial court's failure to instruct the jury on the elements of fraud with respect to the Rule 14e-3 charges was reversible error. *Id.* at 86, 88.

In *Chestman II* the *en banc* Second Circuit reinstated the Rule 14e-3 convictions, but agreed with the panel that, on the particular facts of the case, the Rule 10b-5 and mail fraud convictions could not stand. The panel's opinion on all three issues was vacated. The *en banc* court did not rehear the appeal on the perjury conviction so the panel's reversal of that conviction was not disturbed.

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[5] Hon. Gregory W. Carman, Judge of the United States Court of International Trade, sitting by designation.

The *en banc* court began by canvassing the two strands of Rule 10b-5 liability: the insider trading theory as outlined in *Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980) and *Dirks v. SEC*, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983) and the misappropriation theory of *United States v. Carpenter*, 791 F.2d 1024, 1034 (2d Cir.1986), *aff'd by evenly divided court*, 484 U.S. 19, 108 S.Ct. 316, 98 L.Ed.2d 275 (1987).

In *Chiarella* the Supreme Court held that

> one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.' 445 U.S. at 228 [100 S.Ct. at 1114] (citation omitted).

The Second Circuit stated that in *Dirks* the Supreme Court "held that tippee liability attaches only when an 'insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.'" *Chestman II*, 947 F.2d at 565 (citing and quoting *Dirks*, 463 U.S. at 660, 103 S.Ct. at 3264). The *en banc* Second Circuit summarized this theory of liability:

> [b]inding these strands of Rule 10b-5 liability are two principles—one, the predicate act of fraud must be traceable to a breach of duty to the purchasers or sellers of securities, two, a fiduciary duty does not run to the purchasers or

> sellers solely as a result of one's possession of material nonpublic information.

Chestman II, 947 F.2d at 565-66 (footnote omitted).

The misappropriation theory imposes Rule 10b-5 liability when an individual "misappropriates material nonpublic information in breach of a fiduciary duty or similar relationship of trust and confidence and uses that information in a securities transaction." *Chestman II*, 947 F.2d at 566 (citations omitted). The Second Circuit has held "that the predicate act of fraud may be perpetrated on the source of the nonpublic information, even though the source may be unaffiliated with the buyer or seller of securities." *Chestman II*, 947 F.2d at 566 (citing *Carpenter*, 791 F.2d at 1032). The Second Circuit has so far only applied the misappropriation theory in the employment context.[6]

The *en banc* Second Circuit then went on to state that:

> [a]fter *Carpenter*, the fiduciary relationship question takes on special importance. This is because a fraud-on-the-source theory of liability extends the focus of Rule 10b-5 beyond the confined sphere of fiduciary/shareholder relations to

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[6] The Second Circuit noted that a merger of the two theories can occur. The misappropriations addressed in *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863, 104 S.Ct. 193, 78 L.Ed.2d 170 (1983) (investment banker) and *Materia*, 745 F.2d at 203 (employee at printing company) would also fit under the "temporary insider" theory posited in *Dirks*, 463 U.S. at 655 n. 14, 103 S.Ct. at 3262 n. 14. *Chestman II*, 947 F.2d at 566; *see S.E.C. v. Musella*, 578 F.Supp. 425, 439 (S.D.N.Y. 1984).

> fiduciary breaches of any sort, a particularly broad expansion of 10b-5 liability if the add-on, a 'similar relationship of trust and confidence,' is construed liberally.

Chestman II, 947 F.2d at 567. The Second Circuit noted that a fiduciary duty is not imposed unilaterally when a person is entrusted with confidential information. *Id.* (citing *Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 799 (2d Cir.1980)). The Court noted that certain relationships, among them attorney and client, are hornbook examples of fiduciary relationships. *Id.* at 568. In describing the characteristics of a fiduciary relationship, the Second Circuit stated "[a] fiduciary relationship involves discretionary authority and dependency. One person depends on another—the fiduciary—to serve his interests." *Id.* at 569.

In evaluating the facts of Chestman's conviction, the *en banc* Second Circuit stated the government was required "to establish two critical elements—Loeb breached a fiduciary duty to Susan Loeb or to the Waldbaum family and Chestman knew that Loeb had done so." *Id.* at 570. The Second Circuit found that the government had failed to prove that Loeb was a fiduciary with respect to the Waldbaum family. The Court rejected the notion that marriage automatically imposed a fiduciary duty and held that Loeb was not shown to have been included in the family business. The *en banc* court reversed the Rule 10b-5 convictions as based on insufficient evidence.[7]

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[7] Holding that Chestman's mail fraud convictions were closely tied to the securities convictions, the *en banc* court vacated the mail fraud convictions as well. *Chestman II*, 947 F.2d at 571.

2. Sufficiency of the Evidence

a. Teicher's Convictions Under Rule 10b-5

Applying the principles of *Chestman II* to the case at bar I have no difficulty concluding that the evidence against Teicher was sufficient to sustain his conviction. The jury was repeatedly instructed that to convict the defendants the government had to show that the defendants had traded on confidential information that they knew had been misappropriated in violation of a duty not to disclose. Tr. 7231-45.

Counts 2, 3 and 10 involved trading in the securities of companies that were on the Drexel phantom list. As an employee of Drexel Burnham Lambert with access to the names of the companies on the list, Robert Salsbury was clearly a fiduciary with respect to Drexel's information whether as a "temporary insider" or as a fiduciary. Salsbury testified that Teicher had pressed him for the names of companies on the list even though Salsbury resisted. When Salsbury finally gave Teicher the information, Salsbury warned Teicher not to reveal the names of companies on the list. The evidence was sufficient to establish that Teicher obtained information from the Drexel phantom list and traded on that information. In addition, Teicher understood from his experience the import of knowing the names of companies on the list. Tr. 2253, 3018, 3031-33, 6287-93. This evidence was more than sufficient for the jury to find that Salsbury had misappropriated the information and that Teicher knew the information was obtained in violation of a duty not to disclose and was confidential.

Michael David was clearly a fiduciary with regard to information he learned at Paul Weiss. David was

barred from revealing such information whether as a "temporary insider" under the insider trading theory or as a fiduciary under the misappropriation theory.

As to Count 4, David testified that he told Teicher that the information concerning American Can had been obtained from a Paul Weiss client, Triangle Industries. Tr. 287-88, 767-68. This information was more than sufficient for the jury to find that Teicher knew the information had been misappropriated in violation of David's fiduciary duty and was confidential.

The evidence was sufficient to convict Teicher on Count 9 which charged him with Rule 10b-5 violations in regard to shares in Revco. David testified that he was in Teicher's office and told Teicher that the price for the buyout of Revco was only supposed to go up to $35 per share. David told Teicher that the information came from Andrew Solomon or Marcus Schloss & Co., Inc. and Teicher acted on the tip by selling 5,000 shares short. Tr. 414, 421, 778, 1214-16. While Teicher told a different story in his testimony, Tr. 6269-72, the jury had ample evidence to conclude that Teicher knew the information had been improperly obtained from Marcus Schloss & Co., Inc., was confidential, and had been misappropriated.

The Teicher defendants also challenge their convictions on Count 7 on the ground that the evidence did not establish that Victor Teicher directed trading in shares of Avondale Mills on March 14, 1986.[8] The

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[8] The jury was instructed that trades in Avondale Mills on February 27, 1986 and March 7, 10 and 11, 1986 could not be the basis for convictions of the Teicher defendants. Tr. 7229.

Teicher defendants argue that the government only alleged that Victor Teicher could bind the corporate defendant so that if someone else, namely, a Teicher employee named Daniel Hess, ordered the trading in Avondale Mills Teicher & Co., L.P. cannot be guilty. The Teicher defendants also argue that if Hess ordered trading in Avondale Mills Teicher cannot be guilty on Count 7. Trial Mem. at 13-14; Teicher Post-Trial Mem. at 23; Tr. 6725-29.

The Teicher defendants' argument rests on a unjustifiably narrow view of the evidence at trial, given the light in which the evidence must be viewed on these motions. Hess testified that when David called and told him to buy stock in Avondale Mills Hess went ahead and purchased about 4,000 shares for Victor Teicher & Co., L.P. Hess testified that he made these purchases based on David's call without consulting Victor Teicher. Tr. 2093-94. While these two points in isolation support the arguments of the Teicher defendants, the whole of Hess's testimony gave the jury ample basis to conclude that the trading was done with Teicher's approval.

Hess testified that he had been in the office when Michael David came to the office for two days in March 1986. Hess knew that during this period David helped set up an account at another firm and gave Teicher the tip concerning American Brands. Tr. 2069-84. Hess testified that when David called he asked for Teicher and when he was told that Teicher was not there, he told Hess to purchase shares in Avondale Mills. Tr. 2091-93. Hess testified that on no other occasion did he take a call such as David's and then purchase stock for the firm. In addition, when Hess reported the purchase to Teicher, Teicher

was not concerned and said, Hess testified, "it was fine." Tr. 2095-2098. Other witnesses testified that no trading was done without Teicher's approval. Tr. 3502-03, 3507-10, 4025. The jury was entitled to consider Hess's story and conclude that Teicher authorized the purchase. The fact that Teicher then ratified the sale also gave the jury sufficient evidence to conclude that the purchases were made with Teicher's approval in principle, even if the actual call came from Teicher's coconspirator David.

b. Frankel's Conviction Under Rule 10b-5

The evidence was sufficient for the jury to find Frankel guilty on Count 8 and the related mail fraud count, Count 15. While Frankel argues that the government must show that Salsbury assumed a duty or confidentiality, it is sufficient if the government shows that David breached a duty and Frankel knew of that breach. *See Chestman II*, 947 F.2d at 570. Salsbury testified that he had three conversations with David about American Brands, all of which he relayed to Frankel. Salsbury told Frankel that David's law firm, Paul Weiss, was representing a possible bidder for American Brands. At one point Frankel told Salsbury to caution David to be careful and later asked Salsbury to ask David if the deal was still going to happen. As a former lawyer at a large national law firm Frankel knew well that a lawyer such as David was violating a fiduciary duty by telling Salsbury a client's secrets. Tr. 2304-06, 2336, 4715-17. David's testimony established an incident where Frankel saw David at Teicher's office and Frankel warned him about being seen there. Tr. 410. This evidence gave the jury ample basis to conclude

that Frankel knew the American Brands information had been obtained in violation of David's fiduciary duty.

3. Materiality

The Teicher defendants', and Frankel as to American Brands, move to vacate the securities and mail fraud convictions on Counts 2 (Republic Airlines), 4 (American Can), 5 (Allegheny), 7 and 12 (Avondale Mills), 8, 13 and 14 (American Brands), 9 (Revco) and 10 (Warnaco) because the information at issue was not material. *See* Teicher Trial Mem.; Teicher Post-Trial Mem. at 17-18, 20-25; Teicher Supp. Letter at 3. The Rule 29 motions relating to materiality are denied for the reasons set forth in this Court's Memorandum Opinion and Order dated December 19, 1989 and Memorandum Opinion and Order dated March 9, 1990. *See United States v. Victor Teicher & Co., L.P.*, 726 F.Supp. 1424, 1431-33 (S.D.N.Y.1989); 3/9/90 slip op. at 2-16. The jury was instructed on the materiality issues. Tr. 7234-36. None of the information lacked materiality as a matter of law and the evidence was sufficient for the jury to reach the conclusion it did.

B. Rule 14e-3

After the guilty verdicts the Teicher defendants moved for judgments of acquittal on Counts 11 and 12, based on violations of 15 U.S.C. §§ 78n(e) and 78ff and 17 C.F.R. § 240.14e-3(a), because in *Chestman I* one member of the panel held that Rule 14e-3 was an impermissible extension of the S.E.C.'s rulemaking authority and another held that the jury was improperly instructed on Rule 14e-3. *Chestman I*,

903 F.2d at 86, 88 (opinions of Mahoney, J. and Carman, J.). Teicher Post-Trial Mem. at 5-6.

Despite the fact that *Chestman II* reversed the panel's decision on Rule 14e-3, the Teicher defendants argue that the *en banc* decision was wrongly decided and that Rule 14e-3 is invalid. The Teicher defendants ask this Court to hold that Rule 14e-3 was an improper exercise of S.E.C. rule making authority. Noting that the defendant in *Chestman* will be filing a petition for certiorari, the Teicher defendants urge this Court to invalidate the Rule 14e-3 convictions in order to preserve the issue. *See* Teicher Letter at 1-2.

The government responds that controlling authority in this circuit is that Rule 14e-3 is a valid exercise of the S.E.C.'s rulemaking authority. Gov.Supp.Mem. at 13-14.

In upholding Rule 14e-3(a) the Second Circuit stated:

> based on the plain language of section 14(e) [of the Securities Exchange Act of 1934], and congressional activity both before section 14(e) was enacted and after Rule 14e-3(a) was promulgated, we hold that the SEC did not exceed its statutory authority in drafting Rule 14e-3(a).

Chestman II, 947 F.2d at 563. The Second Circuit's holding could not be clearer and is binding on this Court. Consequently, the Teicher defendants' motions for judgments of acquittal on Counts 11 and 12 are denied.

II. Mail Fraud

In his post-trial motion Frankel argued that the mail fraud count had to be vacated because it was based on the insufficient securities fraud count.[9] Even assuming a fraudulent securities scheme Frankel argued that the mailing of a brokerage house confirmation slip was not integral to or in furtherance of such a scheme. Frankel renews his pretrial motion that Counts 8 and 13 are duplicitous and Count 8 must be dismissed or Counts 8 and 13 merged. Frankel Post-Trial Mem. at 13-15.

Confirmation slips have been held to be integral and in furtherance of mail fraud schemes based on securities fraud. The Second Circuit has stated that such slips can be used to notify other conspirators that purchases have been made, allow other conspirators to keep track of purchases, and help conceal the fraud by maintaining an appearance of normality. *United States v. Grossman*, 843 F.2d 78, 86 (2d Cir.1988), *cert. denied*, 488 U.S. 1040, 109 S.Ct. 864, 102 L.Ed.2d 988 (1989); *see United States v. Marando*, 504 F.2d 126, 129-30 (2d Cir.), *cert. denied*, 419 U.S. 1000, 95 S.Ct. 317, 42 L.Ed.2d 275 (1974).

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[9] Victor Teicher moves to vacate his mail fraud convictions on Counts 13 and 14 because the information on American Brands was not accurate. Teicher contends that inaccurate information cannot be material and so cannot form the basis for a mail fraud conviction. Teicher Trial Mem. at 14-15; Teicher Post-Trial Mem. at 25; Teicher Supp. Letter at 3. Teicher's motion is denied for the reasons set forth in the Court's previous opinion addressing the materiality of the American Brands information. *See* 3/9/90 slip. op. at 10-12. The jury was entitled to draw the conclusion which it obviously did and the information did not lack materiality as a matter of law.

In the case at bar the confirmation slip for 12 American Brands call options served several purposes. Ten options were Frankel's and two of the options were for Salsbury. The slip confirmed Frankel's ownership and purchase price and confirmed these purchases to Salsbury. The slip also notified Salsbury how much Salsbury owed Frankel. The jury had sufficient evidence before it to conclude that the mailing of the confirmation slip was " 'incident to an essential part of the scheme.' " *Schmuck v. United States*, 489 U.S. 705, 712, 109 S.Ct. 1443, 1447, 103 L.Ed.2d 734 (1989) (citation omitted). I have no difficulty reaching the same conclusion.

Prior to the start of the trial Frankel moved to dismiss the securities and mail fraud counts based on American Brands as duplicative. The Court held that the indictment was not duplicative on its face because the securities count would be proved by use of a securities exchange while the mail fraud count would be proved by use of the mails. The Court noted that if the evidence at trial indicated that the two counts were duplicative, the issue could be revisited after the trial. *See Teicher*, 726 F.Supp. at 1436-37. It is axiomatic that an indictment cannot charge the same offense in two counts. *Whalen v. United States*, 445 U.S. 684, 688, 100 S.Ct. 1432, 1436, 63 L.Ed.2d 715 (1980). The test for establishing whether two counts are duplicative was set forth by the Supreme Court in *Blockburger v. United States*, 284 U.S. 299, 304, 52 S.Ct. 180, 182, 76 L.Ed. 306 (1932):

> [W]here the same act or transaction constitutes a violation of two distinct statutory provisions, the test to be applied to determine whether there

> are two offenses or only one, is whether each provision requires proof of a fact which the other does not.

(citation omitted). "[W]hen the *Blockburger* test for multiplicity has been satisfied, and there is no evidence of congressional intent to the contrary, authority to impose cumulative penalties is presumed to be intended." *United States v. Reed*, 639 F.2d 896, 906 (2d Cir.1981) (citation omitted).

The evidence at trial on Count 8 was based exclusively on the use of a national securities exchange for securities fraud with regard to American Brands. American Brands call options were traded on the American Stock Exchange and the parties stipulated that the American Stock Exchange was a "national securities exchange." Tr. 3900. The charge to the jury on the securities fraud count focused on the use of a national securities exchange. Tr. 7251-52. Since Count 8 was concerned exclusively with fraud by use of a national securities exchange and Count 13 was concerned exclusively with the use of the mails, Counts 8 and 13 were not duplicative under the *Blockburger* test. Frankel's motion for judgments of acquittal on these counts or a merger of these counts is denied.

III. Conspiracy

Frankel argues that the conspiracy charge must be retried because the securities and mail fraud convictions must be vacated. Frankel contends that the charged conspiracy had three alleged objectvies: securities fraud with respect to American Brands, mail fraud with respect to American Brands and securities fraud with respect to the Drexel phantom list. Frankel argues that where a conspiracy has multiple

objectives and the proof as to one or more of those objectives is insufficient the evidence on the unproved part of the conspiracy may have prejudiced the jury. *See United States v. Papadakis*, 510 F.2d 287, 297 (2d Cir.), *cert. denied*, 421 U.S. 950, 95 S.Ct. 1682, 44 L.Ed.2d 104 (1975). Frankel argues that the evidence involving American Brands could have prejudiced the jury on the Drexel phantom list. Frankel Post-Trial Mem. 16-18. As I have found that the securities and mail fraud convictions stand, there is no need to address this part of Frankel's argument.

Frankel also argues that the indictment alleged multiple conspiracies, including one conspiracy with respect to David and Paul, Weiss information and a second conspiracy with respect to the Drexel phantom list and Teicher.[10] Without the securities fraud and mail fraud counts concerning American Brands, Frankel argues, the jury would have no basis to conclude that there was a single conspiracy involving the phantom list and the Paul Weiss information. Frankel contends that the conspiracy charge must be retried so the jury can be instructed on this issue. *See Nersesian*, 824 F.2d at 1302. Frankel Post-Trial Mem. at 18. As I have held that the securities and mail fraud convictions relating to American Brands

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[10] The Teicher defendants also argue for judgments of acquittal on Count 1 because the government did not prove a single conspiracy but rather three distinct conspiracies with no connection between them. Teicher Post-Trial Mem. at 19. This Court held prior to trial that the government had properly alleged a single conspiracy. 12/19/89 726 F.Supp. at 1427-1430. The jury was instructed that it must find a single conspiracy. Tr. 7211-13. A "properly instructed jury" found that there was a single conspiracy, *Neresian*, 824 F.2d at 1302, and the Court concludes that there was sufficient evidence to support that finding.

will not be vacated, there is no need to reach Frankel's argument on this point.

IV. Frankel's Perjury Convictions

Frankel was convicted on Count 16 of the indictment which charged him with perjury before the S.E.C. on June 3, 1986. Specification 1 charges that Frankel perjured himself when he testified that he asked Salsbury to do research on American Brands in late February. Specification 2 charges that Frankel committed perjury when he testified that Salsbury did an analysis of American Brands before March 10, 1986. Specification 3 charges that Frankel committed perjury when he testified that on March 10, 1986 Salsbury did not tell him the source of the rumor that American Brands was being taken over by BAT. Specification 4 charges that Frankel committed perjury when he testified that he had not asked Salsbury to do any research on American Brands on March 10, 1086 and that the research was done prior to March 10, 1986.

Relying on the "two witness" rule for perjury convictions, Frankel argues that the evidence was insufficient to convict him of perjury. On Specification 3 Frankel argues that there is no corroboration of Salsbury's testimony that he told Frankel the source of the American Brands information. As to Specifications 1, 2 and 4 Frankel argues that there was no corroborating evidence to establish that Frankel did not ask Salsbury to do research on American Brands prior to March 10, 1986. Frankel Post-Trial Mem. at 19-25.

As the Second Circuit has held,

> [i]n prosecutions for perjury, however, it has long been the rule that a conviction may not be

> obtained solely on the uncorroborated oath of one witness. . . . The rule is satisfied by the direct testimony of a second witness or by other evidence of independent probative value, circumstantial or direct, which is 'of a quality to assure that a guilty verdict is solidly founded.'

United States v. Weiner, 479 F.2d 923, 926 (2d Cir. 1973) (citations omitted). "The 'two-witness' rule requires that the alleged perjurious statement be established either by the testimony of two independent witnesses or by one witness and corroborating evidence that is 'inconsistent with the innocence of the [defendant]' " *Chestman I*, 903 F.2d at 81 (citations omitted).

"In assessing the sufficiency of the corroborative evidence, two elements are considered: '1) that the evidence, if true, substantiates the testimony of a single witness who has sworn to the falsity of the alleged perjurious statement; 2) that the corroborative evidence is trustworthy.' " *Id.* (citing and quoting *Weiler v. United States*, 323 U.S. 606, 610, 65 S.Ct. 548, 550, 89 L.Ed. 495 (1945)). In construing the requirement that corroborating evidence be "inconsistent with the innocence of the defendant" the Second Circuit has said that it "mean[s] no more than that such evidence must tend to substantiate that part of the testimony of the principal prosecution witness which is material in showing that the statement made by the accused under oath was false." *Weiner*, 479 F.2d at 927-28. "When a jury relies on circumstantial evidence, however, it must be demonstrated that this evidence has 'independent probative value' if 'standing alone.' " *Chestman I*, 903 F.2d at 82 (citing and quoting *United States v. Freedman*, 445 F.2d 1220, 1226 (2d Cir.1971)). In light of

these standards the jury in this case was instructed on the "two witness" rule. Tr. 7289-90.

The government's proof on Specification 3, that Salsbury told Frankel the source of the American Brands rumor, satisfied the two-witness rule. David testified that when Frankel saw him in Teicher's office on March 10, 1986, Frankel warned David to be "a little bit more low key." Tr. 410. Frankel admitted warning David and admitted telling Salsbury that it was "not too good an idea" for David to be in Teicher's office. Tr. 4888, 5159. This evidence corroborated Salsbury's testimony and permitted the clear inference that Frankel knew where the American Brands information originated.

The evidence showed that on March 10, 1986 Frankel for the first time permitted Salsbury to purchase two American Brands call options in this account in violation of Drexel and New York Stock Exchange rules. In addition, Geffen testified that he saw Salsbury and Frankel talking on March 10, 1986 and that soon after he heard Frankel tell Salsbury to do research on American Brands. Geffen also testified to actions by Frankel indicating guilty knowledge: Frankel asked Geffen to retrieve Salsbury's check from the cashier at Drexel, Frankel destroyed a margin slip with the check and Frankel instructed Geffen to destroy an incriminating page from Frankel's desk calendar. Tr. 4282-84, 4313. All of this evidence corroborated Salsbury and led to the clear inference that Frankel lied when he told the S.E.C. that Salsbury had just passed on a "rumor."

The government's case also provided ample corroborating evidence to prove that Frankel lied to the S.E.C. about Salsbury's research on American Brands,

the subject of Specifications 1, 2 and 4. Frankel testified that he had had Salsbury do research in February 1986 and that Frankel had not asked Salsbury to do research on March 10, 1986. Specifications 1, 2 and 4. Salsbury testified that he had not done research in February and that Frankel first asked him to do research after the purchase of American Brands call options on March 10, 1986. Tr. 2318-2320.

In addition to the corroborative evidence on Specification 3 above, which also goes to corroborate Salsbury on the issue of the timing of research into American Brands, Frankel's own tortured attempts to explain the date of the research corroborates Salsbury's testimony that he did no research on American Brands before March 10, 1986.

On June 3, 1986 Frankel initially told the S.E.C. that "the Salsbury analysis was before March 10" and that Salsbury "had already done the financial analysis on my request a while before [March 10]." The S.E.C. then confronted Frankel with a memorandum he had written to Drexel's in house counsel Paul Merolla on April 29, 1986. That memorandum stated that "on March 10, 1986, I told Bob that I was considering buying some American Brands calls and asked him to do a brief financial analysis of the underlying common stock." The memorandum mentioned nothing about research being done before March 10, 1986. Tr. 5036-38. When Frankel saw this memorandum at the S.E.C. he stated that it was wrong and said "I don't know why I wrote that."

On June 5, 1986 Frankel gave another version to the S.E.C. and also relied on this version at the trial before this Court. In this version Frankel stated that he had asked Salsbury to do an analysis in February

and had only asked him to do an "update" on March 10 to compare American Brand to other tobacco stocks. Tr. 4973, 5048. But the research in Salsbury's notebook on the back of a page dated March 12, 1986 is an analysis of the break-up value of American Brands using 1984 numbers. It makes no mention of any other tobacco companies. Tr. 5048. The jury was entitled to consider Frankel's story, *United States v. Bagaric*, 706 F.2d 42, 66 (2d Cir.), *cert. denied*, 464 U.S. 840, 104 S.Ct. 134, 78 L.Ed.2d 128 (1983), and its implausibility corroborates Salsbury's testimony.

As there was ample evidence presented at trial to satisfy the "two witness" rule, Frankel's motion to vacate the perjury conviction is denied.

ORDER

Defendants' motion are denied in their entirety. Sentencing of the Teicher deefndants will be on April 27, 1992 at 4:30 p.m. and sentencing of Frankel will be on April 28, 1992 at 4:30 p.m. in Room 307 of the United States Courthouse.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the — day of April, one thousand nine hundred and ninety-three.

Docket Number: 92-1301, 92-1302

UNITED STATES OF AMERICA, APPELLEE

v.

VICTOR TEICHER, VICTOR TEICHER & CO., AND ROSS FRANKEL, APPELLANTS

[Filed Apr. 26, 1993]

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by Appellants Teicher, et al.

Upon consideration by the panel that decided the appeal, it is

Ordered that said petition for hearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other

judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT
ELAINE B. GOLDSMITH
Clerk

/s/ Carolyn Clark Campbell
CAROLYN CLARK CAMPBELL
Chief Deputy Clerk

APPENDIX D

STATUTES AND REGULATIONS INVOLVED

15 U.S.C. § 78j

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality or interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78n

(e) It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, desceptive, or manipulative.

15 U.S.C. § 78ff

(a) Any person who willfully violates any provisions of this chapter (other than section 78dd-1 of this title), or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $1,000,000, or imprisoned not more than 10 years, or both, except that when such person is a person other than a natural person, a fine not exceeding $2,500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

17 C.F.R. § 240.10b-5

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality or interstate commerce, or of the mails or of any facility or any national securities exchange.

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.14e-3

(a) If any person has taken a substantial step or steps to commence, or has commenced a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:

(1) The offering person,

(2) The issuer of the securities sought or to be sought by such tender offer, or

(3) Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.